NORTON ROSE FULBRIGHT

International Restructuring Newswire

A quarterly newsletter from the bankruptcy, financial restructuring and insolvency team at Norton Rose Fulbright

Q3 2022

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To our clients and friends:

We are all seeing challenging times ahead. The war in Ukraine rages on. The surge in the cost of energy and goods and the supply and trade disruptions look set to continue for some time as the geo political picture plays out and countries look to protect themselves to weather this storm. The World Bank Group's Global Economic Prospects report issued in June 2022 forecasts a "sizeable downgrade to the outlook" with global growth expected to slow from 5.7% in 2021 to 2.9% this year.

Rising costs of goods and energy and the resulting slump in consumer demand will inevitably have a damaging effect on businesses and their counterparts whether they are regionally or globally focussed. Governments are having to continue to look at ways they can ease business strain and encourage investment which has in many jurisdictions led to changes to insolvency laws in recent years. We continue to believe that being prepared by keeping up to date with all the options open to companies is key.

In this issue, our colleagues in Australia, Germany, the Netherlands, the UK and the US examine some recent decisions that question some of our well-trodden rules and conventions on the use of restructuring and foreign recognition processes to write off debt and on aircraft lessors' rights to their assets under the Cape Town Convention following the Australian High Court's decision in Virgin Australia. In addition, we look at the possible revival of pre-packs in the Netherlands, the EU recognition of UK restructuring plans and schemes of arrangement following Brexit and finally, we take a look at the UNCITRAL Model Law on cross border insolvency 25 years on from its introduction.

We hope you find these articles useful.

Howard Seife
Global Head
Bankruptcy, Financial Restructuring and Insolvency

Sarah Coucher
Global FRI Strategic Initiative Director

In the news

INSOL International London 2022 Conference

June 26–28, 2022

Norton Rose Fulbright's global financial restructuring and insolvency group was a proud sponsor of INSOL International's annual conference in London. **Scott Atkins**, Australian Chair and President of INSOL International, presided over the conference – welcoming over 900 colleagues and clients from around the world to discuss the complex issues business are facing.

Lee Pascoe co-chaired a panel at the INSOL Fellows Forum at INSOL London 2022 titled "Insolvency Proceedings and Cryptocurrency: A Catch Up," which provided INSOL fellows with a refresher on the current issues identified in ongoing global insolvency proceedings in the cryptocurrency space.

Mark Craggs chaired a plenary panel session at INSOL London 2022 on "Deconstructing International Restructurings", focusing on required personal skills and attributes of restructuring professionals, stakeholder drivers and jurisdiction-specific cultural issues and sensitivities. As European Co-Chair of the INSOL G36 Committee, Mark also opened the G36 breakfast by introducing the guest speaker, Kenneth Feinberg, a leading expert in mediation and alternative dispute resolution who served as Special Master of the September 11th Victim Compensation Fund.

ARITA Vic/Tas Division Conference

May 4, 2022

Fiona Murray-Palmer spoke at the conference on recent decisions and developments in Australian preference law and insolvent trading.

ARITA NSW/ACT Division Conference

May 18, 2022

Noel McCoy and **Jonathon Turner** moderated panels at the ARITA NSW/ACT Division Conference in Australia. Noel moderated a panel on 'Safe Harbour Review' and Jonathon a panel on 'An economic and geo-political view of the post-COVID world: risks and opportunities.'

TMA Southwest Regional Conference

May 19, 2022

Kristian Gluck moderated a panel at Turnaround Management Association's 15th Annual Southwest Regional Conference in San Antonio, Texas. The panel discussed the NRA's Chapter 11 bankruptcy filing and dismissal.

Madrid Bar Association

May 27, 2022

Koen Durlinger was invited to lecture to Ilustre Colegio de Abogados de Madrid (the Madrid Bar Association). The lecture was part of the curriculum of the Madrid Bar Association's Master in Business Restructuring. Koen discussed the Dutch scheme, its many features as well as important precedent case law.

UNCCA Seminar – UNCITRAL Model Law on Cross-Border Insolvency

May 27, 2022

John Martin, Australian partner and President of the International Insolvency Institute, and **Scott Atkins**, Australian partner and President of INSOL International, hosted a seminar in collaboration with UNCCA reviewing the UNCITRAL Model Law on Cross-Border Insolvency following the 25 year anniversary of the law.

Conference on Preventive Restructuring

June 2, 2022

Koen Durlinger was invited by Centrum restrukturalizace a insolvence Harryho Pollaka (of the University of Economics in Prague), to take part in a panel at their yearly conference – discussing preventive restructuring frameworks across various European jurisdictions. Koen discussed the implementation of the Dutch scheme (WHOA). The panel consisted of experts from Austria, Poland and Germany.

Sanierungsberater Annual Conference

June 2-3, 2022

Dr. Sylwia Maria Bea participated on a panel on distressed M&A at Sanierungsberater's annual conference in Hamburg.

ABI New York City Bankruptcy Conference

June 10, 2022
Eric Daucher participated in a panel on bankruptcy litigation at the American Bankruptcy Institutes' annual NYC conference. Eric spoke on recent developments in fraudulent transfer litigation.

Global Restructuring Review

Dr. Sylwia Maria Bea, recently appointed as EMEA Co-Head of NRF's Financial Restructuring and Insolvency group, was profiled in the June 14 edition of Global Restructuring Review.

Annotation of Dutch Scheme (WHOA) Case Law

Omar Salah was invited to write an annotation on the court order on the Dutch scheme (*Wet homologatie onderhands akkoord*, **WHOA**) on the WHOA of football club ADO Den Haag, whereby the WHOA was used to implement a distressed M&A deal. The annotation is for JOR with case law reference JOR 2022/187. JOR is a leading law review on insolvency law and corporate law in the Netherlands.

Airfinance Journal

Noel McCoy published an article in the *Airfinance Journal* covering the High Court of Australia's decision in the Virgin Australia administration.

INSOL International

Lee Pascoe co-authored the Australian chapter of the INSOL International publication "The Restructuring of Corporate Groups: A Global Analysis of Substantive, Procedural and Synthetic Group Procedures," published June 2022.

David Goldman delivered an academic paper on 'The role of disharmony in cross-border insolvency' during the INSOL London Academic Colloquium Programme.

South Square Digest

Scott Atkins, Noel McCoy and **Lee Pascoe** co-authored three separate articles examining the insolvency landscape in Australia and the United Kingdom, published in the March special edition of *South Square Digest*. The focus of the articles included: the tools available in Australia and the UK for appointees to an insolvent corporation; what the move to net zero emissions mean for businesses, directors and the insolvency landscape; and antecedent transactions and cryptocurrency.

Deal Awards

Winner of the **2022 IFLR Europe Restructuring Deal of the Year**, for the second consecutive time, for our financial restructuring team's work in advising the lenders to subsea services provider **DeepOcean** in a landmark restructuring case.

Winner of **Airfinance Journal's 2021 Asia-Pacific Deal of the Year** and **Airline Economics' 2021 Asia Pacific Restructuring Deal of the Year** for our representation of **Philippine Airlines, Inc**. in its consensual restructuring, which was implemented in PAL's chapter 11 plan. This is the first-ever pre-negotiated chapter 11 restructuring by an airline.

Winner of **Airfinance Journal's 2021 Latin America Deal of the Year** for our representation of Castlelake in **Avianca Airline's** US$482 million sale and leaseback back transaction with respect to six A330 freight aircraft, which was a key component to implementing Avianca's chapter 11 plan of reorganization.

Winner of one of **Global Trade Review's 2022 Best Deals** for our representation of **Biosev**, a Brazilian sugar ethanol producer and a subsidiary of Louis Dreyfus, in its US$1.3 million multi-jurisdictional debt restructuring.

Winner of **Canadian Law Awards 2022 Insolvency & Restructuring Deal of the Year** for our role as counsel to Deloitte Restructuring Inc. as the court-appointed monitor of **Groupe Dynamite** in its restructuring process, under the CCAA and US Chapter 15.

Hong Kong Court comments on the interplay between the Rule in *Gibbs* and Chapter 15 recognition

Jason Blanchard, Francisco Vazquez

In a recent decision, the High Court of Hong Kong sanctioned a scheme of arrangement proposed by a Bermuda company to restructure certain debt governed by Hong Kong law. ***See Re Rare Earth Magnesium Technology Group Holdings Ltd*** **[2022] HKCFI 1686. The sanctioning of such schemes is not uncommon in Hong Kong. However, the High Court took the extra step of elaborating on the meaning of the Rule in** ***Gibbs*****, which continues to be the law in the UK and many other jurisdictions, by effectively stretching the Rule in** ***Gibbs*** **to cover US law-governed debt despite the fact that the US does not follow the Rule in** ***Gibbs*** **as a matter of US law. The decision highlights risks for Hong Kong or any other companies that try to restructure US law-governed debt through an offshore scheme of arrangement and then need to seek recognition and enforcement in Hong Kong or another common law jurisdiction that follows the Rule in** ***Gibbs*****. This article examines the court's discussion of the Rule in** ***Gibbs*** **and the potential risk to companies that restructure their US law-governed debt using offshore tools. In order to best set the stage, the first part of this article provides a brief background of the Hong Kong case.**

Case Background

Rare Earth Magnesium Technology Group Holdings Limited is an investment holding company incorporated in Bermuda. Its shares are listed on the Hong Kong Stock Exchange. The company, which is a member of a broader group, operates through its subsidiaries that are principally based in Hong Kong, the British Virgin Islands, and mainland China. The company's principal indebtedness consisted of approximately HK852,533,000 of unsecured interest-bearing bonds issued by the company that are governed by Hong Kong law. Rare Earth's parent guaranteed the bond debt.

After suffering financial losses due to COVID-19, the company filed a winding-up petition in Bermuda and sought the appointment of soft-touch provisional liquidators to restructure the company's debt. In a soft-touch provisional liquidation, the company remains under the day-to-day control of the company's directors but has the benefit of a moratorium to protect the company from creditor enforcement actions. In general, a soft-touch provisional liquidator will work with the directors to restructure the company's debts. In this instance, the company (with the provisional liquidator's assistance) asked the High Court to sanction a scheme of arrangement to restructure the company's unsecured debt, including the bond debt governed by Hong Kong law.

The scheme generally provided for a discharge of the company's bond debt and included a release of the parent's guarantee. Pursuant to the scheme, a creditor could choose from several options: (i) the term of repayment of the existing bonds would be extended for five years which would entitle creditors to payment of interest and interim payments over a five-year period with additional payment and enforcement rights against Rare Earth's parent; (ii) creditors would receive convertible bonds in the amounts of their claims with a five-year maturity with the option to convert the bonds to shares in the company or redeem the bonds on the maturity date at an amount equal to 100% of the outstanding principal amount of their claims; or (iii) a combination of the two options.

In determining whether to sanction the scheme, the High Court considered several factors, including whether (a) the scheme is for a permissible purpose, (b) the requisite majorities of creditors voted in favor of the scheme, (c) creditors had been given sufficient information about the scheme to enable them to make an informed decision on whether or not to support it, and (d) an intelligent and honest person acting in accordance with their interest might reasonably approve the scheme. Given the transnational nature of the company, the *Rare Earth* court focused on an additional factor: whether the scheme would be effective in other jurisdictions relevant to the company's business and

operations. According to the court, it would not be a proper exercise of its discretion, and it would serve no purpose to sanction a scheme if it would not be effective in the primary foreign jurisdictions where the company operates. Thus, the court evaluated whether the compromise of the company's Hong Kong law-governed debt under the scheme, which was to be sanctioned under Hong Kong law, would be recognized by courts in Bermuda, the company's place of incorporation, and the Cayman Islands, the company's parent's place of incorporation, particularly in light of the Rule in *Gibbs*.

The Rule in *Gibbs* and its application by the High Court to the Scheme of Arrangement

The Rule in *Gibbs* is an English common law rule derived from an 1890 decision by the English Court of Appeal in *Antony Gibbs and sons v. La Societe et Commerciales des Metaux* (1890) 25 QBD 399. The rule provides that a contract, including a loan, can only be discharged or amended in accordance with its governing law. Accordingly, under the Rule in *Gibbs*, debt governed by, for example, English law can generally only be discharged under English law, including by a scheme of arrangement sanctioned by an English court. However, there is an exception. Under the Rule in *Gibbs*, debt can be discharged or compromised under the law of a jurisdiction other than the situs of the governing law if the creditor to whom that debt is owed submits to the jurisdiction of that foreign court.

In this instance, the High Court concluded that the Rule in *Gibbs* would be followed by the courts in the offshore jurisdictions, particularly Bermuda and the Cayman Islands. Consequently, the court found that the company's Hong Kong scheme of arrangement that discharged Hong Kong law-governed debt would be recognized in Bermuda, the Cayman Islands, and the other offshore jurisdictions in which the company operates. The court was silent as to whether China, another place where the company operated, would recognize the scheme. However, it noted that "[t]here is no requirement for a scheme to be effective in every jurisdiction worldwide, provided that it is likely to be effective in the key jurisdictions in which the company operates or has assets." Thus, the court sanctioned the scheme finding that the company satisfied all of the pertinent factors, including demonstrating the scheme would be effective in the other jurisdictions relevant to the company's business.

Relying on the rule in *Gibbs*, the *Rare Earth* court further noted that if a substantially similar scheme had been sanctioned by an offshore jurisdiction (and not in Hong Kong), the scheme would effectuate a restructuring of the Hong Kong law-governed debt only as to those creditors that had submitted to that jurisdiction. Creditors that did not submit to the offshore jurisdiction would not be bound to the scheme and could pursue their remedies against the Hong Kong company in Hong Kong.

Recognition of foreign restructurings under Chapter 15 of the Bankruptcy Code

In addition to elaborating on the applicability of the *Gibbs* rule to Hong Kong law-governed debt, the court took the opportunity to express a risk to a company that uses an offshore scheme to restructure US denominated debt. The court observed that many mainland businesses listed on the Hong Kong Stock Exchange carry US denominated debt and instruments governed by US law. According to the court, under the *Gibbs* rule, US law-governed debt may be discharged or restructured only under US law notwithstanding that US law does not impose such a requirement or have an equivalent legal doctrine. In its analysis, the court highlighted the differences between Chapter 11 and Chapter 15 of the US Bankruptcy Code. Thus, a brief explanation of the differences between the chapters follows.

Chapter 11 of the Bankruptcy Code allows companies to reorganize and restructure their debts. The Chapter 11 debtor usually remains "in possession," may continue to operate its business, is given certain powers and duties of a trustee, and, with court approval, may borrow money, sell assets, and reject undesirable contracts, among other things. The culmination of a Chapter 11 case is generally confirmation of a Chapter 11 plan that will typically provide for the discharge and/or restructuring of debt regardless of the governing law. In other words, a US court may, and often does, approve a Chapter 11 plan that restructures debt governed by non-US law.

In contrast, Chapter 15 of the Bankruptcy Code, which is based on the Model Law on Cross-Border Insolvency promulgated by the United Nations Commission on International Trade Law, provides a statutory framework for recognizing foreign restructuring proceedings and specifically provides for comity, assistance, and cooperation by the US bankruptcy court with foreign courts. It does not provide for a mechanism to discharge or restructure debt. That occurs in the foreign insolvency case. Under Chapter 15, a US bankruptcy court must recognize a foreign proceeding if certain requirements are satisfied. Following recognition, a US bankruptcy court may enter an order enforcing a foreign restructuring plan or a scheme of arrangement, provided that certain additional requirements are met, particularly that the court is satisfied that the interests of creditors and other interested entities, including the debtor, are sufficiently protected. Similarly, a confirmed Chapter 11 plan that restructures US law-governed debt should be recognized by foreign courts in countries that have adopted the Model Law, subject to any additional requirements of those countries' insolvency laws.

Based on the court's understanding of the Bankruptcy Code, the court concluded that, because Chapter 15 does not independently provide for a mechanism to discharge debt, the enforcement of a foreign restructuring plan by a US bankruptcy court under Chapter 15 would not be sufficient to satisfy the Rule in *Gibbs*. Thus, according to the court, a scheme approved in an offshore jurisdiction and recognized by a US bankruptcy court under Chapter 15 would not be consistent with the Rule in *Gibbs* and would not be treated by a Hong Kong court as compromising US law-governed debt. Thus, a creditor of a company that implements a scheme to restructure US law-governed debt may take action against the company in Hong Kong unless the creditor submitted to the jurisdiction of the primary court sanctioning the scheme. Chapter 15 recognition or enforcement of the scheme alone would not suffice.

To reach this conclusion, the court examined a decision by the US Bankruptcy Court for the Southern District of New York in *In re Agrokor d.d.*, 591 B.R. 163 (Bankr. S.D.N.Y. 2018). In *Agrokor*, the court considered whether to enforce a Croatian restructuring plan that restructured English law-governed debt under Chapter 15. Although the High Court of England and Wales had previously recognized the Croatian proceeding, it did not decide whether to approve the Croatian court's treatment of the English law-governed debt. In analyzing the issues, the bankruptcy court acknowledged the *Gibbs* rule's application under English law and noted that the plan may not be effective under English law but nevertheless extended comity to the Croatian court's treatment of the English law-governed debt within the territorial jurisdiction of the US.[1]

Relying on the *Agrokor* court's comments concerning its territorial jurisdiction, the *Rare Earth* court reasoned that recognition under Chapter 15 means US law-governed debt may not be discharged outside the US. Thus, according to the High Court:

> A scheme in an offshore jurisdiction purporting to compromise debt governed by United States law will not be effective in Hong Kong. Recognition of the scheme under *Chapter 15* does not constitute a compromise of debt governed by United States law, which satisfies the Rule in *Gibbs*. The result

1 Though not determinative of the outcome, the bankruptcy court noted that it had previously recognized and enforced an English court decision modifying New York law-governed debt in an English scheme of arrangement. *Agrokor d.d.*, 591 B.R. at 168 (citing In re *Avanti Communs. Grp. PLC*, 582 B.R. 603 (Bankr. S.D.N.Y. 2018)).

> is that if a company has a creditor, which did not submit to the jurisdiction of the offshore court the creditor will be able to present a petition in Hong Kong to wind up the Company and if, for example, the creditor is a bond holder whose debt is not disputed, obtain a winding up order unless the debt is settled.

Based on this analysis, the court opined that a creditor holding US law-governed debt could seek relief from the High Court notwithstanding recognition of a foreign insolvency proceeding by the US bankruptcy court (unless that creditor had previously submitted to the US court's jurisdiction).

Conclusion

The *Rare Earth* decision provides guidance on the application of the Rule in *Gibbs* in Hong Kong. According to the High Court, Hong Kong law-governed debt can be restructured under substantive Hong Kong law. Hong Kong law-governed debt may also be restructured under an offshore scheme and binding on a creditor that submits to the offshore jurisdiction. However, according to the High Court, a company should be wary of using offshore tools to restructure US law-governed debt (or any debt governed by the laws outside of the offshore jurisdiction) if it would like the scheme to be effective in Hong Kong. Under the Rule in *Gibbs*, which is applicable in Hong Kong, US law-governed debt can only be restructured in the US, principally under Chapter 11. There is, however, no such requirement in the US. Indeed, a US court may, and often does, approve a Chapter 11 plan that restructures debt governed by non-US law and may recognize or enforce foreign plans or schemes of arrangement that restructure US law-governed debt under Chapter 15. While such restructurings may be allowed under US law (and elsewhere), they may not be effective in Hong Kong or in a jurisdiction that applies the Rule in *Gibbs* in the manner described by the *Rare Earth* court.

The High Court also noted that a creditor may take action against a company in Hong Kong, notwithstanding the terms of the offshore scheme or that it was enforced under Chapter 15, but tempered this conclusion when it noted this risk may not be significant where the creditors that hold "debt of any material value have agreed to the terms of the" offshore restructuring. However, given the apparent risk that an offshore restructuring of US law-governed debt may not be enforced in a jurisdiction that applies the Rule in *Gibbs*, a company that is contemplating restructuring US law-governed debt should consider US alternatives, including Chapter 11 of the US Bankruptcy Code. Absent a US restructuring of US law-governed debt, creditors in a jurisdiction that applies the Rule in *Gibbs* may be able to derail the restructuring.

Francisco Vazquez is senior counsel in our New York office and Jason Blanchard is senior counsel in our Dallas office. Both are members of the firm's financial restructuring and insolvency group.

The pre-pack in the Netherlands may very shortly revive!

Prof. Omar Salah, Koen Durlinger and Rik van der Laan

Since the judgment of the European Court of Justice in the *Estro* case in 2017, the use of pre-packs had almost completely disappeared in the Netherlands. While looking ahead in the Q4 2021 issue of our *International Restructuring Newswire*, two of the authors of this article expressed their view that the highly anticipated judgment of the European Court of Justice in the *Heiploeg* case potentially offered reason for optimism for the revival of Dutch pre-packs. On 28 April 2022, the European Court of Justice handed down its judgment in the *Heiploeg* case which confirmed this view – the Dutch pre-pack indeed lives.

Introduction

The pre-pack was widely used as a restructuring tool in the Netherlands in the aftermath of the global financial crisis. In a Dutch pre-pack process, a debtor in financial distress will negotiate and prepare an asset deal. The debtor will request the court to appoint a prospective bankruptcy trustee and prospective supervisory judge. The prospective bankruptcy trustee and prospective supervisory judge, while formally having no basis or formal tasks under the Dutch Bankruptcy Act, will closely monitor the process. Once the negotiations with a potential purchaser are close to being finalised, the debtor will file for bankruptcy, the court will appoint the prospective bankruptcy trustee and prospective supervisory judge as the actual bankruptcy trustee and supervisory judge, respectively. The bankruptcy trustee will then sign and close the transaction that was prepared prior to the bankruptcy. The aim of using a pre-pack is to avoid the negative impact on the value of the business when pursuing a sale of a distressed business through a bankruptcy process. By using a pre-pack, enterprise value is preserved as much as possible, and the business (or parts of it) may be sold as a going concern for the maximum value.

In 2017, the use of pre-packs in the Netherlands was halted as a consequence of the judgment of the European Court of Justice (**ECJ**) in the *Estro* case.[1] Estro was the largest childcare company in the Netherlands with close to 380 childcare centres throughout the Netherlands and with around 3600 employees. When it suffered financial distress, the business was sold using a pre-pack in an attempt to rescue the business. In the context of that transaction, approximately 250 childcare centres were purchased by Smallsteps. It should be noted that Smallsteps, as the purchaser of part of the business of Estro, was affiliated with (the shareholder of) Estro. Estro's bankruptcy trustee terminated all employees of Estro, following which almost 2600 of those (former) employees were offered a new employment contract by Smallsteps.

In the *Estro* case, the question was whether the (former) employees of Estro were transferred to Smallsteps by operation of law based on the principles of the European Directive on 'Transfer of Undertakings and Protection of Employees' (**TUPE**),[2] or whether these principles did not apply to the Estro pre-pack on the basis of the exception in bankruptcy (the **bankruptcy exception**). The bankruptcy exception to the automatic transfer of employment contracts is applicable to a transfer of an undertaking, business, or part of an undertaking or business, if:

- the transferor is the subject of bankruptcy proceedings (or any analogous proceedings);
- such proceedings have been instituted with a view to the liquidation of the assets of the transferor; and
- the transfer is under the supervision of a competent public authority (which may be an insolvency practitioner authorised by a competent public authority).[3]

The ECJ considered that, in the given circumstances, it was apparent that the pre-pack was "*aimed at ensuring*

1 European Court of Justice 22 June 2017, C-126/16, ECLI:EU:C:2017:489 (*Estro*).

2 Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses, or parts of undertakings or businesses.

3 Article 5(1) TUPE.

the continuation of the undertaking where that procedure is designed to preserve the operational character of the undertaking or its viable units". As such, the ECJ held that the pre-pack proceedings were ***not*** instituted with a view to the liquidation of the assets of Estro. The ECJ further considered that this view is not altered by the possibility that a pre-pack also maximises satisfaction of the creditors' collective claims.

In addition, the ECJ held that the pre-pack procedure had no basis in Dutch national legislation, that the prospective bankruptcy trustee and prospective supervisory judge had no formal powers, and accordingly, the pre-pack procedure was not supervised by a public authority.

The ECJ concluded that the pre-pack for Estro, therefore, did not meet the requirements of the bankruptcy exception under TUPE or its implementation in Dutch law.

As a result of this ruling, pre-packs were no longer considered a feasible tool in Dutch restructurings where the workforce needed reshaping.

Heiploeg case: the Dutch Supreme Court

The judgment of the ECJ in the Estro case effectively ended the use of the pre-pack in the Netherlands, leaving exceptional cases aside. With the *Heiploeg* case, however, the Dutch Supreme Court had the chance to request the ECJ to - in essence - reconsider its decision on Dutch pre-packs. In that request, the Dutch Supreme Court indicated that (in its preliminary view) the bankruptcy exception did in fact apply to the Heiploeg pre-pack on the basis that, contrary to what the ECJ ruled in the *Estro* case, the Heiploeg pre-pack was instituted with the purpose of liquidating assets of the transferor, as well as the fact that the pre-pack was conducted under the supervision of a competent public authority.

The Dutch Supreme Court found that the purpose of the pre-pack was to liquidate the assets of the bankrupt debtor, given that the bankruptcy of *Heiploeg* was inevitable absent the going concern sale, the purchaser of the business was not affiliated with Heiploeg and the District Court had appointed a prospective bankruptcy trustee and prospective supervisory judge with the aim to achieve the highest possible return for the creditors of the potentially (soon to be) bankrupt company.

The Dutch Supreme Court further concluded that pre-packs involve actual supervision by a competent authority because the pre-pack is monitored by a prospective bankruptcy trustee and prospective supervisory judge who, although being appointed by the court without any legal powers when carrying out their tasks, have duties that do not differ from the duties of the bankruptcy trustee and supervisory judge in insolvency proceedings. Furthermore, the prospective bankruptcy trustee should act in the interest of the collective creditors and other societal interests, such as preservation of employment, under supervision of the prospective supervisory judge. In addition, the Dutch Supreme Court concluded that the deal that is negotiated pre-bankruptcy is actually signed and closed by the bankruptcy trustee, with approval of the supervisory judge in bankruptcy, and that the court may appoint a different bankruptcy trustee and supervisory judge if the prospective bankruptcy trustee and the prospective supervisory judge have not taken the interests of the creditors into account. Finally, the Dutch Supreme Court found that the prospective bankruptcy trustee may be held liable in the same way as a bankruptcy trustee in insolvency proceedings.

Advocate General: no bankruptcy exception

In his conclusion of 9 December 2021,[4] which was published shortly after the Q4 2021 issue of our *International Restructuring Newswire*, Advocate General Pitruzzella at the ECJ nonetheless concluded that the Heiploeg pre-pack was not instituted with a view to the liquidation of the assets of the transferor since the primary objective of a procedure aimed at continuation of the undertaking is the safeguarding of the undertaking concerned. Further, the Advocate General considered that there is no space for an untethered case-by-case approach to a determination of the primary objective of a pre-pack, given the legal uncertainty and ambiguities this would cause due to the absence of statutory or regulatory provisions governing the pre-pack procedure in the Netherlands. Therefore, the Advocate General found that the circumstances raised by the Dutch Supreme Court were irrelevant to the question of whether a pre-pack is instituted with a view to the liquidation of the assets of the transferor or with a view to continuation of the undertaking. The Advocate General further concluded that the prospective bankruptcy trustee and prospective supervisory judge do not have any formal statutory powers, which meant that the third condition for the bankruptcy exception also was not met.

ECJ: bankruptcy exception may apply

Contrary to the conclusion of the Advocate General, on 28 April 2022 the ECJ found the circumstances raised by the Dutch Supreme Court were relevant . The ECJ considered that, with the information provided by the Dutch Supreme Court in the context of the presented preliminary questions, it was necessary to verify in each particular case and situation, whether the pre-pack and insolvency proceedings at issue were being carried out with a view to the liquidation of the business instead of with a view to the reorganisation of that undertaking.[5] The ECJ furthermore held that it was necessary to establish not only that the primary objective of those proceedings was to satisfy, to the greatest extent possible, the claims of all creditors generally, but also that such primary objective would be achieved in the relevant proceedings.

The ECJ found that there was supervision by a competent public authority since the prospective bankruptcy trustee and prospective supervisory judge were appointed by a competent court, which not only defines their duties - such duties not being substantially different from the duties of the actual bankruptcy trustee and the supervisory judge in insolvency proceedings - but also reviews the exercise of those duties when the insolvency proceedings are subsequently opened. This review includes the court deciding whether or not the same persons should be appointed as the actual bankruptcy trustee and supervisory judge, and is further supported by the fact that the prospective bankruptcy trustee may be held liable in the same way as a bankruptcy trustee in insolvency proceedings.

The ECJ did however agree with the Advocate General that the lack of a legal framework for the pre-pack is the source of legal uncertainty, which is also evidenced by the fact that not all Dutch courts have granted requests for pre-packs in the absence of such a legal framework.

In sum, based on the further information provided by the Dutch Supreme Court, the ECJ held that the pre-pack proceedings at issue were carried out with a view to the liquidation of the assets of the transferor and under the supervision of a competent public authority if the following exist:

- the transfer of (part of) the undertaking has been prepared prior to the institution of insolvency (or analogous) proceedings with which the liquidation of assets is envisaged and during which the transfer is carried out;

4 Conclusion Advocate General Pitruzzella 9 December 2021, C-237/20, ECLI:EU:C:2021:997 (*Heiploeg*).

5 European Court of Justice 28 April 2022, C-237/20, ECLI:EU:C:2022:321 (*Heiploeg*).

- this transfer is carried out in the context of a pre-pack that has as its primary objective to facilitate a liquidation of the undertaking as a going concern during the insolvency (or analogous) proceedings that satisfies a maximum disbursement to the creditors of the debtor and preserves employment to the extent possible; and
- the pre-pack procedure is governed by statutory or regulatory provisions.

Impact

The ECJ therefore clarified that the bankruptcy exception may be applicable if a pre-pack has in fact been instituted with a view to liquidation of the assets of the undertaking as a going concern for the purpose of maximising returns for the creditors' collective claims (which, in turn, may be substantiated through the circumstances raised by the Dutch Supreme Court).

However, the ECJ set forth an important prerequisite: the pre-pack must be governed by statutory or regulatory provisions. This should not be viewed as a radical change of direction from the ECJ, but rather as a further nuance to the *Estro* judgment. This means that the time has come for the Dutch legislature to pick up the gauntlet (again). The condition introduced by the ECJ requires that the Dutch pre-pack have a basis in law. It is now up to the Dutch legislature to introduce statutory or regulatory provisions governing the pre-pack procedure in the Dutch Bankruptcy Act.

In the Q4 2021 issue of our *International Restructuring Newswire*, we discussed various legislative initiatives that are relevant in the context of pre-packs, being:

- the draft bill 'Act on Continuity of Enterprises I' (*Wet Continuïteit Ondernemingen I*; "**WCO I**");
- the legislative amendment (*novelle*) to the WCO I published on 25 May 2021; and
- the draft bill 'Act on Transfer of Undertaking in Bankruptcy' (*Wet overgang van onderneming in faillissement*; "**WOVO**").

These legislative initiatives had been paused in anticipation of the judgment of the ECJ in the *Heiploeg* case. It is expected that the Dutch government will resume working on these draft bills with a sense of urgency now that the ECJ has handed down its judgment.

WCO I was in fact the legislative proposal to codify the pre-pack into the Dutch Bankruptcy Act. However, a legislative amendment to WCO I sought to allow for a phased approach to the enactment of the pre-pack in the Netherlands, whereby the pre-pack framework would be made available only for enterprises with activities that serve social interests (such as companies active in the healthcare, education, energy, waste processing, internet and telecom sectors), and - depending on the outcome of the *Heiploeg* case - subsequently, for other debtors in general. Now that the ECJ has opened the door for pre-packs, we would expect and find it desirable that the Dutch legislature withdraws the legislative amendment to the WCO I and pursues the enactment of the WCO I for all businesses, in accordance with the initially proposed legislation.

Conclusion

The *Heiploeg* judgment opens the door for the use of pre-packs in the Netherlands (again). The ECJ clarified that the bankruptcy exception under TUPE may apply, if a pre-pack has in fact been instituted with a view to liquidation of the assets of the undertaking as a going concern and provided that the pre-pack is governed by statutory or regulatory provisions. If the bankruptcy exception applies, employees are not transferred to the purchaser of the business by operation of law. This allows for a restructuring of the workforce to realize maximum value for the creditors of a bankruptcy estate, which is a great addition to the Dutch restructuring toolkit along with the new Dutch scheme (the WHOA) which excludes employees from its application (restricting the ability to restructure employment liabilities under a WHOA proceeding).

In light of the ECJ's requirement that the bankruptcy exception only applies if the pre-pack procedure has a statutory or regulatory basis, the Dutch government is expected to soon resume its work on the WCO I (and the WOVO) to create a legal framework for pre-pack procedures.

The revival of the pre-pack would be a welcome addition to the restructuring tools in the Netherlands. We look forward to new developments and the re-birth of the Dutch pre-pack.

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Overcoming *Gibbs*: Restructuring of English law-governed liabilities in Europe

Dr. Sylwia Maria Bea, Mark Craggs, David J. Schrader, Jan Peter Weiland, Lorenz Scholtis

It has been some two and a half years since the UK officially withdrew from the European Union on January 31, 2020 (with the subsequent transition period having ended on December 31, 2020). In the restructuring world, the fall-out from "Brexit" continues, in terms of legal consequences and new issues continuing to emerge on a regular basis.

In the years leading up to Brexit, much had been done to facilitate cross-border restructurings in Europe. Insolvency and the legal regimes that govern it had been identified as obstacles to the free movement of capital within the customs union. The European legislators and the Court of Justice of the European Union, as well as EU member states themselves, worked to streamline national legal frameworks to reflect the increasingly transnational nature of business operations and, correspondingly, insolvency proceedings and corporate and financial restructurings occurring in the life-cycles of multinational enterprises. The European Insolvency Regulation (EIR) laid the foundation for the allocation of jurisdiction for opening insolvency proceedings, as well as their recognition once opened, and widespread cooperation between courts in member states. EU member states have now endeavoured to implement the EU Restructuring Directive (Directive (EU) 2019/1023) (the **Restructuring Directive**) amidst the challenging backdrop of the COVID-19 pandemic in order to make available to debtor companies effective, preventive restructuring frameworks, which are modelled in many respects along the lines of what had come to be regarded – at least pre-Brexit – as the omnipotent UK scheme of arrangement.

Where does the UK stand post-Brexit for European restructurings?

When the European Commission announced in a recommendation in 2014 that it sought to require the implementation of early-stage preventive legal frameworks in all member states, scholars and practitioners alike anticipated a wave of forum-shopping and different member states' restructuring regimes vying for competitive advantage as financially troubled debtors sought to turn around their fortunes.

For the better part of two decades, UK schemes had largely dominated the market for financial restructurings of sizeable UK and non-UK companies across the EU – and even beyond European borders. By the time the Restructuring Directive had been approved by the European Parliament and the Council of the EU in June 2019, the UK was well on its way to implementing the "leave" referendum vote delivered three years earlier, and so predictions on the consequences for the European restructuring market abounded.

While opinions on the prospects for mutual recognition of insolvency and restructuring measures in the EU and the UK post-Brexit diverged vastly among professionals (and, in some circles, continue to do so), one thing became clear: key legislation for EU-nexus restructurings – notably the EIR and the Brussels I Regulation on jurisdiction and the recognition and enforcement of civil and commercial judgments – would no longer apply in relation to the UK.

Case study; and an obstacle from 1890

The repercussions of Brexit on pre-insolvency financial restructuring are best illustrated through a case study.

A Germany-based manufacturer (the **Corporation**) with dozens of operating entities across continental Europe is financed primarily through an internationally-syndicated secured loan facility at the parent company level, governed by English law (the **HoldCo Debt**). Secondary sources of external financing to the group are through certain secured and unsecured trade finance facilities made available to subsidiaries (the **OpCo Debt**). There is some overlap among the lender groups for the HoldCo Debt and the OpCo Debt. There are also intercompany loans, and the Corporation has guaranteed certain of the OpCo Debt.

Following declining sales, COVID-19-related disruptions, overleveraging and alleged fraud at the management level of one of its key subsidiaries, the Corporation finds itself in severe financial distress and defaults on its payment obligations under the HoldCo Debt. Payment defaults follow under the OpCo Debt. The financing parties – the HoldCo Debt lenders and the OpCo Debt lenders – agree to sign temporary standstill agreements in relation to their respective facilities, for the purposes of allowing the formulation of a workable turnaround plan. It is hoped that entry into the standstill will facilitate negotiations for the implementation of suitable operational and financial restructuring measures to ensure the successful delivery of the plan and the continuation of the group as a going concern.

It becomes apparent, however, that a consensual restructuring is unlikely to be feasible. Since the Corporation has its statutory seat and centre of main interests (**COMI**) in Germany, its working assumption throughout has been that restructuring plans in respect of both itself and the relevant borrowers under the OpCo Debt under the relatively newly-implemented StaRUG[1] – Germany's version of a preventive restructuring framework – will be the main available option for ensuring the compromise of claims of potential dissenting creditors, if the "Plan A" consensual deal appears to be unattainable. Ideally, then, the Corporation and its affected subsidiaries would achieve a holistic restructuring within Germany, utilizing the form of compromise now available under the StaRUG.

1 Stabilisierungs- und Restrukturierungsgesetz (StaRUG).

However, it is only the OpCo Debt that is governed by German law; the HoldCo Debt is governed by English law. The ramifications of this seemingly incidental choice of law are significant: under English common law, following the so-called "Rule in *Gibbs*", which derives from the 1890 judgment in *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* (25 Q.B.D. 399), contractual claims can only be discharged in accordance with their governing law. As such, provided that a creditor with English law-governed debt does not submit to the jurisdiction of the relevant foreign court, its claims cannot be discharged in the course of the relevant foreign proceeding. The practical effect of the Rule in *Gibbs* is that the StaRUG cannot be a one-size-fits-all restructuring solution for the Corporation and its affected subsidiaries.

As a consequence of the Rule in *Gibbs*, English law-governed liabilities cannot be compromised by EU member states' preventive restructuring schemes

The implications of the Rule in *Gibbs* for the Corporation's group are as follows: a German StaRUG restructuring plan can validly compromise only the OpCo Debt lenders' claims and those of any creditors which are governed by German law, the laws of any other EU member state, or the laws of any third country which recognizes the StaRUG proceedings as a valid and effective compromise.

If and to the extent that the Corporation intends to include in the StaRUG the claims of the HoldCo Debt lenders – which account for the largest share of the Corporation's financial obligations, dwarfing the amount of OpCo Debt – the purported compromise under the StaRUG will not be effective as a matter of English law, unless the HoldCo Debt lenders were to submit to the jurisdiction of the German courts. In other words, while the HoldCo Debt can be restructured by a German restructuring plan as a matter of German law, the effects of the plan would not be recognised in the UK. Therefore, in view of the sheer amount of the HoldCo Debt liabilities relative to other liabilities of the Corporation, a German StaRUG proceeding in isolation is unlikely to be sufficient to stave off the insolvency of the Corporation.

Since there is no equivalent to the Rule in *Gibbs* under German law, one possibility might be to reverse the strategy and simply subject all German and non-UK law-governed liabilities, including the claims of the OpCo Debt lenders, to a UK scheme of arrangement or Part 26A restructuring plan, along with the claims of the HoldCo Debt lenders. This, however, leads the Corporation to consider the next issue: will UK restructuring measures, if approved, be recognized as being valid and effective in Germany and other EU member states?

The international recognition of UK schemes and restructuring plans in the EU remains an open question

Whether, and to what extent, schemes of arrangement and their younger sibling, restructuring plans, will be recognized in EU member states post-Brexit has been the subject of lively discussion amongst international restructuring professionals in recent years. Various viewpoints have been expressed but consensus has yet to be reached.

In reviewing the possibilities for the recognition of UK restructuring proceedings in Germany, and in the absence of applicability of Brussels I, the Corporation and its advisors consider the following potential bases for recognition:

- Article 8 (1), Article 4 (1) of the Hague Convention on Choice of Court Agreements
- 1960 UK-German Treaty
- Art. 12 (1) lit. d Rome I Regulation
- Art. 33 (1) Lugano Convention
- Sec. 343 German Insolvency Code (*Insolvenzordnung*)
- Sec. 328 German Code of Civil Procedure (*Zivilprozessordnung*)

As matters stand, none of the above bases provide sufficient certainty of recognition being granted, from the perspective of the Corporation.

There remain questions as to whether or not the Hague Convention applies in the case of schemes (including in relation to whether schemes fall within an exclusion for insolvency and compositions, and whether a non-consensual form of compromise, so far as dissenting creditors are concerned, qualifies as an exclusive choice of court agreement).

The 1960 UK-German Treaty operates to uphold strict priority of national recognition provisions of the recognising state (Art. 2 (3)) and therefore does not constitute a viable legal basis for recognition.

Rome I is of universal application, i.e. it applies in the case of choice of laws of third countries as well as EU member states. It defines the law applicable to contracts and defers to an express choice of law by contracting parties. Therefore, the effects of a UK scheme or restructuring plan on English law-governed liabilities might be capable of recognition in Germany on this basis. This would not of itself provide a basis for the recognition of a UK compromise of German law-governed liabilities, however, since the parties to such contracts have chosen German law as the governing law. Furthermore – similar to the position vis-à-vis the Hague Convention – it is perhaps questionable to consider a UK scheme or restructuring plan as being "contractual" in nature, in the case of non-consenting creditors.

The Lugano Convention, like the EIR and Brussels I, is no longer applicable to the UK post-Brexit. While the UK did in fact apply to accede separately to the Lugano Convention in April of 2020, the EU Commission has taken a rather clear stance, in issuing a statement recommending that the EU should not provide its consent to the UK's accession.

It is apparent, therefore, that supranational instruments do not provide a clear basis for recognition of a UK scheme of arrangement or restructuring plan in Germany. Accordingly, determination of the question comes down to national recognition rules. No solution can be found in Sec. 343 of the German Insolvency Code, however, since it applies exclusively to insolvency proceedings. Arguably, however, both schemes and restructuring plans may lack the requisite characteristic for these purposes of being a collective proceeding involving all creditors; consequently, it remains an open question whether they qualify as insolvency proceedings within the scope of the German Insolvency Code.

Finally, recognition could be achieved under Sec. 328 of the German Code of Civil Procedure, which broadly governs the recognition of foreign "court decisions" in Germany. Amongst other requirements, the application of the provision depends on so-called reciprocity, meaning that recognition must be rejected if, in the reverse case, a corresponding decision by a German court would not be recognized in equivalent circumstances in the United Kingdom. This is where the Rule in *Gibbs* may once again come into play, as it would almost certainly preclude reciprocal recognition of a German StaRUG proceeding in the UK.

Despite the above, it is worth pointing out that challenges to cross-border schemes were relatively rare pre-Brexit – notwithstanding that schemes previously sat outside the recognition framework under the EIR (as being creatures of corporate and not insolvency legislation) – and also to note that there had been conflicting authorities in terms of the application of Brussels I to schemes in any event. Accordingly, it is to be hoped that any concerns about recognition of schemes and – also now restructuring plans – post-Brexit are considerably overplayed.

On a practical level, too, it is worth noting that difficulties are likely to be encountered from a scheme recognition perspective only in circumstances in which a compromised, aggrieved creditor is inclined to take the point and proceed to litigate it. Clearly, this will depend on the facts in any given case, but it is often the case that the economics militate against making such claims – as do the downside risks of mounting a challenge which ultimately fails (notably, from an adverse costs perspective).

Parallel reorganization schemes in the UK and EU member states could constitute a new best-practice to combat uncertainties in mutual recognition

The apparent legal impasse in which the Corporation finds itself might be capable of being resolved through taking a comparatively rarely-seen and unconventional approach, which may well become the preferred means of effecting cross-border financial restructurings in the years to come: the commencement of parallel or "in-tandem" reorganization schemes in multiple jurisdictions. The advent and refinement of the various preventive restructuring frameworks across the EU by reason of the Restructuring Directive is opening up new and exciting possibilities in this regard.

As both the German StaRUG restructuring plan and UK schemes and restructuring plans are selective proceedings (meaning they are capable of affecting only certain creditors' claims and do not necessarily extend to all creditors' claims), it seems appropriate for the Corporation to commence a StaRUG proceeding in Germany and only subject the OpCo Debt lenders and potentially other creditors with German and non-UK law-governed liabilities to the compromise under the StaRUG. Simultaneously, the Corporation would commence a scheme or Part 26A restructuring plan in the UK, which would include only the HoldCo Debt lenders and their English law-governed claims.

Another possibility in an appropriate case – which might be more attractive while the position vis-à-vis recognition remains unsettled – would be to subject the same creditor

claims to equivalent compromises in different jurisdictions (subject to local law approval tests and thresholds), effectively "back-to-backing" (for example) the terms of a StaRUG with a UK restructuring plan, to ensure that the compromise is binding and effective in all relevant jurisdictions – i.e. parallel forms of compromise properly so-called. There are historic analogues for this approach in cases like Drax Holdings (on which Norton Rose Fulbright represented the debtors).

In addition, it is worth bearing in mind that a UK restructuring plan or scheme may operate so as to, and be approved on the basis that it will, become effective on an inter-conditional basis with a German StaRUG restructuring plan. This will allow the courts in both jurisdictions, and all affected stakeholders, to reach a high level of certainty that a holistic and all-encompassing restructuring is capable of being achieved in both key jurisdictions. This allows some scope for coordinating a StaRUG proceeding with the process for seeking the approval (or sanction) of a UK plan or scheme. Sec. 62 StaRUG expressly states that the restructuring plan may contain conditions, in which case judicial approval will be given if such conditions have been satisfied or if there are no reasons that they cannot be satisfied.

The fact that the Corporation has its statutory seat and COMI in Germany does not restrict the availability of a UK scheme or restructuring plan, because, unlike in many other jurisdictions, the debtor requires only a "sufficient connection" with the UK in order for the UK courts to have jurisdiction. In this regard, the location of significant assets or domicile of creditors in the UK are generally a strong indicator, as is the existence of English law-governed debt.

Conclusion

As matters stand, it appears that the implementation of in-tandem or parallel schemes might well be the principal reliable reorganization method for EU groups with significant English law-governed liabilities, since taking this course avoids many of the prevailing uncertainties regarding mutual recognition of formal restructuring processes.

That said, however, this course inevitably involves the incurring of increased costs for debtors and creditors, as court and legal fees accrue in relation to both (or indeed all such) proceedings. In addition, coordinating large professional and advisory teams across borders invariably increases the burden of structuring and coordinating efforts, with a view to ensuring a smooth and efficient process and a successful and lasting outcome to the restructuring. It seems clear, then, that financial restructurings which utilize parallel schemes will remain primarily the preserve of large-scale multinational groups. Where this route is feasible, however – including in the case of the Corporation from our case study – it is likely to present the most robust and reliable option for effectively implementing a successful cross-border restructuring across an enterprise group.

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The Model Law on Cross-Border Insolvency: a silver lining but not a silver bullet

Scott Atkins and John Martin

On the 25th Anniversary of the UNCITRAL Model Law for Cross-Border Insolvency, Norton Rose Fulbright's Australian chair Scott Atkins, the president of INSOL International, and partner John Martin, the president of the International Insolvency Institute, explain why it reflects a silver lining but not a silver bullet for modified universalism and harmonisation.

Where are we at?

Today, 30 May, marks the 25th anniversary since the Model Law on Cross-Border Insolvency (Model Law) was adopted by the United Nations Commission on International Trade Law (UNCITRAL).

This is an important milestone. The Model Law is rightly regarded as one of the foundations of cross-border restructuring and insolvency policy and practice, and has played an instrumental role in facilitating greater recognition, cooperation and coordination in pursuit of modified universalism – one of the core policy underpinnings of insolvency law in which courts seek to ensure the operation of a single insolvency proceeding extending on a worldwide basis (subject to protections for local creditors).

In doing so, the Model Law has helped to centralise insolvency proceedings, avoiding the multiplicity of proceedings opened in different jurisdictions and thereby reducing costs and the prospect of inconsistent judgments, creditor disputes and the piecemeal breakup of a debtor's business.

This has in turn enhanced the prospect of successful restructuring attempts for viable entities, increased creditor returns (whether in the context of a restructuring or a liquidation) and helped to support financial stability and economic growth.

By creating a certain, predictable recognition and cooperation framework based on familiar and well-understood and tested concepts such as a debtor's centre of main interests and establishment, foreign main and non-main proceedings and mandatory and ancillary relief, the Model Law has also incentivised cross-border investment and finance, as creditors can negotiate *ex-ante* confident of what their rights will be in the event of corporate default.

In the absence of the Model Law – or comparative regional frameworks such as the European Insolvency Regulation recast (EIR 2015) – the common law recognition process based on comity and the civil law exequatur procedure do not provide for consistent and predictable outcomes. Likewise, legislative "aid and auxiliary provisions" (invoked upon the issue of a letter of request by a foreign court) leave cooperation largely to the discretion of individual courts, and this operates as an impediment to the efficient administration of cross-border insolvencies as well as capital and investment flows on a macro level.

Where are we going?

To date, the Model Law has only been adopted by 50 states across 54 jurisdictions. Many of the major economies in the world – including most EU nations, as well as China, India, Malaysia, Hong Kong and Indonesia – are yet to adopt it. To create consistent and predictable outcomes for creditors, it is important to continue the strong efforts of UNCITRAL, as well as INSOL International and the World Bank, to encourage greater uptake of the Model Law. Indeed, international regulatory and policy frameworks are only ever as effective as their local implementation. The multilateral framework offered by the Model Law provides consistency and predictability for financially distressed debtors and creditors on a global basis, which is lacking in bilateral treaties that are necessarily confined to a limited geographic area (such as the May 2021 Joint Record of Meeting between Mainland China and Hong Kong).

But the Model Law is only one piece of the puzzle. Indeed, global economic, policy and regulatory settings have now evolved and there are new challenges we must face and adapt to in ensuring a robust, working and effective cross-border restructuring and insolvency framework, which supports the restructure of viable entities, maximises creditor returns

and operates as a genuine and indispensable component of economic growth, financial stability and global investment opportunities.

The Model Law can now serve as a launching pad to pursue, in tandem with the further uptake of the Model Law itself, the adoption and implementation of additional international frameworks for both recognition and cooperation in a corporate group setting, and the recognition and enforcement of insolvency-related judgments; the further development and adoption of judicial cooperation and mediation protocols; and clarity on applicable law in an insolvency proceeding.

Cross-border insolvency processes for corporate groups

As it stands, the Model Law itself is designed to deal with single corporate entities. Yet the pace of globalisation and rapid digitisation and technological change has spurred the continued growth of business conducted across borders – along with complex global corporate group arrangements that often see parent entities and subsidiaries located in different jurisdictions.

In an insolvency context, there is accordingly a need to ensure a framework for recognition and cooperation adapted to the unique needs and circumstances of corporate groups. For that reason, UNCITRAL adopted the Model Law on Enterprise Group Insolvency (MLEGI) in July 2019. The MLEGI draws on the concept of planning proceedings and the appointment of a group representative to develop a group insolvency situation for multiple corporate group members set out in the EIR 2015, and also provides for mutual recognition of planning proceedings and court cooperation to implement solutions designed by a group representative.

The widespread adoption and implementation of the MLEGI would increase the potential for complex corporate group restructuring arrangements to be effectively negotiated and executed in multiple jurisdictions simultaneously, under a guided framework for concentrated insolvency proceedings, creditor cooperation and consultation and negotiated outcomes under legislated and predictable laws. It would also enhance the efficiency of liquidation processes for unviable corporate group entities in a manner that would reduce costs and increase creditor returns. Having in place a clear and recognised framework under the MLEGI would also overcome the need to rely on judicial discretion under synthetic restructuring processes of the kind seen in *Re Collins & Aikman Europe SA* ([2006] EWHC 1343), the inherent uncertainty of which is a deterrent to financial and capital flows to support complex global enterprises and business structures.

Insolvency-related judgments

While the Model Law provides a framework for recognition and cooperation concerning restructuring and insolvency *procedures*, it does not of itself automatically facilitate the recognition of foreign *judgments* arising out of those procedures.

And yet without a common, predictable framework for the enforcement of judgments, a creditor with security over assets in a foreign jurisdiction critical to a successful restructuring attempt could enforce its rights over those assets outside the scope of a restructuring plan approved by a court in the main proceeding. This risk is real and not merely theoretical – indeed, English courts continue to apply the *Gibbs* rule, which allows creditors to avoid the consequences of a debt discharge by a foreign restructuring plan if their debts are governed by English law.

To that end, the expanded uptake of the Model Law ought to be pursued along with the adoption and implementation of the further framework adopted by UNCITRAL in July 2018, the Model Law on the Recognition and Enforcement of Insolvency-Related Judgments (MLIRJ). This is a critical underpinning to be able to, in practice, negotiate and implement an effective multi-jurisdictional restructuring plan for viable debtors binding on all creditors.

Cooperation protocols

While the Model Law contemplates court and insolvency practitioner cooperation in articles 25 to 27, the precise means of that cooperation is left for specific protocols outside the Model Law.

To ensure the architecture of the Model Law is in fact implemented in practice, the greater adoption of specific court-to-court cooperation protocols that provide for joint hearings, information sharing and prescribed modes of communication should be encouraged.

The existing protocols developed under the American Law Institute-International Insolvency Institute Global Principles for Cooperation in International Insolvency Cases (2017), the EU-based Communication and Cooperation Guidelines for Cross-Border Insolvency (2007) and Cross-Border Insolvency Court-to-Court Cooperation Principles and Guidelines (2014), as well as the Guidelines (2016) and Modalities (2019) of the Judicial Insolvency Network, provide useful principles to draw on and encourage capacity building initiatives in developing nations, as well as knowledge sharing, training and judicial colloquia among courts on a global basis. It is these direct court-to-court linkages, built upon human connections and familiarity with different legal systems, which can support the development of formal cooperation and communication protocols – one of the keys to an effective and efficient cross-border restructuring and insolvency framework.

Indeed, we have seen the benefit of judicial cooperation – through joint hearings and coordination of substantive insolvency outcomes – in the recent *Halifax* matter, which involved a joint sitting between the Federal Court of Australia and the High Court of New Zealand in December 2020 in relation to parallel insolvency processes for an Australian parent entity and a New Zealand subsidiary, as well as in the *Nortel Networks* matter in 2013, in which Canadian and United States courts conducted joint hearings and put in place court coordination and cooperation protocols. In each case, there were significant cost savings for the insolvency

estates, maximised creditor returns and a consistent approach to decision-making, which helped to build creditor trust and support for the coordinated administration put in place by the courts.

Mediation

The appointment of a mediator is one of the ways in which the cooperation framework set out in articles 25 to 27 of the Model Law may be implemented in practice – working alongside judicial communication protocols.

Indeed, mediation can operate in strong partnership with the Model Law to enhance the prospect of restructuring for large and small enterprises alike. The pursuit of mediation as a genuine institutional quasi-insolvency process is a novel and feasible option in creating the flexibility needed to achieve effective cross-border insolvency outcomes. Indeed, mediation can assist courts and insolvency practitioners to narrow and resolve creditor disputes and can encourage creditors to engage and negotiate together towards a restructuring plan while minimising the need for court intervention.

As we celebrate the fundamental change the Model Law effected to achieve greater recognition, cooperation and harmonisation in cross-border restructuring and insolvency proceedings, it is important to now look to leverage the Model Law's architecture to create new ways to ensure optimal insolvency outcomes for debtors, creditors, economies and communities.

Applicable law

While providing for an effective and consistent approach to *procedural* outcomes in cross-border restructuring and insolvency matters, the Model Law does not directly facilitate harmonisation in *substantive* insolvency laws involving different jurisdictions. Currently, different approaches have been taken by courts globally on the extent to which the law of the state where the insolvency proceedings are opened (*lex fori concursus*) applies to all aspects of the insolvency proceedings. These differences create the potential for fragmentation, creditor disputes and increased costs that deplete working capital essential for the restructure of viable entities, as well as the value of the insolvency estate available for distribution in a liquidation context.

Drawing on the EIR 2015, in which the expectation is that the *lex fori concursus* ought to apply to all aspects of the insolvency proceedings with very limited exceptions, UNCITRAL's Working Group V (Insolvency) is currently seeking to develop draft legislative provisions that will set that same expectation on a global basis (so that, unlike the EIR 2015, it is not limited to EU-specific insolvencies).

The incorporation of these provisions, once finalised, in domestic legislation ought to be encouraged along with the further adoption and implementation of the Model Law, the MLEGI and the MLIRJ, as well as the judicial cooperation and mediation protocols referred to above. This will ensure a consistent and harmonised approach to both procedural and substantive legal processes and insolvency approaches that will create predictable outcomes for creditors, maximise the prospect of a successful restructuring for viable businesses and ensure the most efficient liquidation process possible for unviable entities.

Conclusion

On this milestone anniversary, we should celebrate the transformation the Model Law has effected in the cross-border restructuring and insolvency policy and regulatory framework, and the contribution it has made to more predictable, efficient insolvency outcomes for debtors and creditors – maximising corporate and business rescue and creditor returns and benefiting the economy, the financial system and cross-border investment and financial flows.

But in the years ahead, the achievement of modified universalism and the harmonisation of cross-border insolvency and restructuring processes depends on the adoption and implementation of other instruments and protocols concerning recognition, enforcement, judicial cooperation, mediation, applicable law and the unique circumstances of complex corporate group structures which extend across borders. In pursuing these outcomes, insolvency and restructuring laws and policies can become a key part of building stronger economies and communities across the globe as we look to, in every sense, "build back better" from the pandemic and help prepare businesses for the challenges ahead in the world.

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High Court of Australia decision in the Virgin Australia administration – a world first under Alternative A of the Cape Town Convention and Aircraft Protocol

Noel McCoy

In a world-first decision of an ultimate appellate Court on the Aircraft Protocol to the Cape Town Convention on International Equipment, the High Court of Australia recently dismissed the appeal of an aircraft engine lessor (Willis Lease Finance Corporation), which was seeking certain lease-based terms for the redelivery of its engines against the administrators of Virgin Australia: see *Wells Fargo Trust Company, National Association (as owner trustee) v. VB Leaseco Pty Ltd (administrators appointed)* [2022] HCA 8.

This decision will have important ramifications for financing of expensive aviation assets. The Convention on International Interests in Mobile Equipment (**Cape Town Convention**) and the Aircraft Protocol to the Cape Town Convention (**Aircraft Protocol**) require uniformity and predictability in their application across the 87 countries that have adopted them.[1] The High Court's judgment will be influential in other jurisdictions applying the Convention and Protocol and currently provides the most authoritative statement as to the effect of Alternative A of Art XI of the Protocol relating to "*Remedies in Insolvency*".

The issue

At stake was the scope of an insolvency administrator's obligation under Alternative A in Article XI of the Aircraft Protocol to "*give possession*" of aircraft objects (airframes, engines, records and related equipment) after the expiry of the "*waiting period*" (moratorium) in an insolvency administration, in this case, the administration of the Virgin Australia companies.

The Convention

The Cape Town Convention and the Aircraft Protocol became law in Australia on 1 September 2015 under the *International Interests in Mobile Equipment (Cape Town Convention) Act 2013* (Cth). With respect to insolvency matters, Australia elected to adopt the strong form Alternative A in Article XI of the Protocol, which has similarities to Section 1110 of the US Bankruptcy Code.

The Cape Town Convention and the Aircraft Protocol prevail over any law of the Commonwealth and any law of a State or Territory, to the extent of any inconsistency with them.

At the time of its enactment, the Australian Government identified that the "*Cape Town Convention is an international legal system that protects secured lenders of aircraft objects such as aircraft, airframes, engines and helicopters and reduces the risk and cost associated with financing these objects*."[2]

The litigation

In April 2020, following the onset of the COVID pandemic, the Virgin Australia Group of companies, Australia's second major airline, appointed administrators.

In June 2020, at the end of the 60 day "*waiting period*" specified under Article XI(2) of the Aircraft Protocol (Alternative A as adopted by Australia), Willis sought from the administrators of the Virgin Australia companies the return of its four CFM International (model CFM-56-7B24) aircraft engines, suitable for use in Boeing 737 aircraft in accordance with certain lease-based redelivery terms.

1 Article V(1) of the Cape Town Convention

2 Second Reading Speech, the Hon. Anthony Albanese MP, Minister for Infrastructure and Transport and Minister for Regional Development and Local Government, 29 May 2013

Willis was successful at first instance before the Federal Court of Australia and redelivery was ordered in a manner consistent with the express contractual regime for redelivery. However, that decision was overturned by the Full Federal Court of Australia on an appeal by the administrators.

Willis obtained special leave to appeal to the High Court of Australia in April 2021 and the hearing of the High Court appeal took place in November 2021. Judgment was delivered by the High Court on 16 March 2022.

Willis argued that Article XI(2) of the Aircraft Protocol was the source of a remedy that Willis could call upon to seek to be "*given possession*". Article XI is entitled "*Remedies on Insolvency"*; XI(2) is the first substantive sub-article and the reference point for sub-articles (3) through to (7) of Article XI. Of the two alternatives available for adoption by signatories, Australia opted for the so-called "*strong form*" Alternative A (see [2020] FCA 1269 at [117]), which uses the language of "*give possession*" and is to be contrasted with the language in Alternative B which uses the language of giving the creditor the "*opportunity to take possession*" in accordance with local domestic law.

Further, Willis argued that when determining what the obligation to "*give possession*" means, Article XI(13) supplies the answer by requiring a remedy to be exercised in a commercially reasonable manner and deeming that the exercise of remedy in accordance with the parties' agreement will be taken to be reasonable.

Specifically, Art XI(13) applies Article IX(3) of the Aircraft Protocol to the exercise of remedies under Article XI. Article IX states: "*Article IX of this Protocol shall apply to the exercise of any remedies under this Article*". Article IX(3) in turn requires all remedies under the Cape Town Convention to be exercised in a commercially reasonable manner, which is deemed to be exercising remedies in accordance with the underlying (lease) agreement unless "*manifestly unreasonable*."

The administrators argued that the obligation to "*give possession*" required no more than providing the opportunity for the creditor to take possession of its aircraft objects. That was said to be consistent with the use of those words in Art XI(5), which it was argued had to be read consistently with Art XI(2).

The administrators contended in the High Court that evincing an intention to surrender possession would be sufficient to provide the creditor with the relevant opportunity to take possession. On the facts of the case, the administrators had claimed they had done so by taking steps under Australian law to disclaim the engines by issuing notices under section 443B of the *Corporations Act* 2001 (Cth).

The High Court's reasoning and conclusions

The High Court held that Article XI(2) (i.e Alternative A) is **not** a remedy, saying that Article XI(2) "*does not in form or in substance give an additional remedy to the creditor*" (at [44]).

The High Court held that instead, "*Art XI of the Protocol is framed to apply in circumstances where the creditor has a right to take possession of the aircraft object under Art 8 or Art 10 of the Convention*" (at [45]).

The High Court concluded that "*it is for the debtor or insolvency administrator to take whatever steps may be necessary to provide an opportunity for the exercise of the right to take possession which the creditor has under Art 8 or Art 10 of the Convention*."

Finally, the High Court held that that Willis' claim for redelivery pursuant to the terms of the leases remained available as an "additional remedy" under Article XII of the Convention. Article XII operates by picking up "*remedies agreed upon by the parties*". However, on the High Court's interpretation the right to seek relief pursuant to Article XII remained subject to the stay under local insolvency law (at [57]).

The High Court held that its interpretation of the Cape Town Convention is consistent with the Cape Town Convention's purpose of facilitating capital market financing of aircraft equipment.

The High Court agreed with Willis insofar as it held that Article XI(13) requires a remedy to be exercised in conformity with Article IX(3) in a commercially reasonable manner (that is, in accordance with the lease unless "*manifestly unreasonable*") (at [45]). But because Art XI(2) (i.e Alternative A) was not characterised as a remedy, the "*commercially reasonable*" constraint had "*no application to the performance of the obligation that Art XI(2) imposes on the debtor or insolvency administrator*".

The High Court held that the administrators' "*invitation to Willis…to take control of the aircraft engines where they were situated in Australia fulfilled the obligation to 'give possession'*" (at [55]).

Practical ramifications

The essential element in the High Court's reasoning was that the obligation to "*give possession*" in Alternative A is **not** a remedy.

With that point of departure, it followed that Article XI(2) is to be interpreted without reference to the commercial reasonableness test required by Articles XI(13) and IX(3).

Instead, the Court interpreted Alternative A within the context of the Aircraft Protocol as a provision directed towards limiting the moratorium that might otherwise prevent creditors exercising remedies to take possession of aircraft objects under Article VIII or Article XI of the Cape Town Convention.

Specifically, according to the High Court, Alternative A has the effect, once the 60-day waiting period expires, of overriding the Cape Town Convention's preservation of local insolvency law moratorium on the enforcement of rights to property, enabling the creditor to exercise the right to take possession of its aircraft objects.

In Australia, this in effect means that Article XI(2) overrides, in the context of an administration, the stay on enforcement under section 440B of the Corporations Act, once the 60-day waiting period is over, enabling the lessor or secured creditor to take possession of its aircraft objects.

At that point, the insolvency administrator is to "*take whatever steps may be necessary to provide an opportunity for the exercise of the right to take possession*."

What remains unclear is the scope of the obligation to take "*whatever steps may be necessary*".

Unlike the decision of the primary judge, which gave certainty, the "*whatever steps may be necessary to give the opportunity to take possession*" test is somewhat elusive as to the content of the obligation and tends to beget more questions than it answers. For example,

- Is it sufficient to offer physical collection of the important records (expressly included within the definition of Aircraft Objects in the Aircraft Protocol) from a filing cabinet in disparate foreign airport hangars or must the insolvency administrator do more? What about those records that require certification or sign-off from the airline?
- What happens in the case of engines leased or owned by one lessor, for example on an airframe owned by the airline or another lessor but stuck in a location where the engine cannot be removed? Must the airline assist with a ferry flight to an airport with suitable maintenance facilities?

- What responsibility does the administrator have in removing liens asserted, for example, by airports? Does "*whatever steps may be necessary*" encompass an obligation to remove or simply facilitating the lessor's efforts in doing so?

The Full Federal Court sought to ameliorate the uncertainty arising from that test by remitting to the primary judge "*the factual issues as to what may be required in order to give possession in light of our reasons*" (at [110]). However, it was sufficiently clear that the Full Federal Court contemplated the administrators taking some positive facilitative steps to enable the creditor to overcome any barriers to taking possession beyond a mere disclaimer saying: (at [106])

> To do so may require the taking of affirmative steps by the insolvency administrator beyond simply disclaiming the property. Merely submitting to the claim by the creditor may not be enough.

While the High Court adopted the "*whatever steps may be necessary*" test in its reasoning, when it came to applying its reasoning, the High Court held that by the administrators simply disclaiming the aircraft objects on an "*as is, where is*" basis, they had fulfilled the obligation to "*give possession*" (at [55]). Further, as noted above, the High Court in making orders, dispensed with the remittal proceeding.

It is unclear whether the High Court intended that the content of the "*whatever steps may be necessary*" test to be different to that contemplated by the Full Court of the Federal Court. The High Court's application of its reasoning to the facts suggests that simply disclaiming the aircraft objects is enough, but the High Court did not explain whether this is so as a matter of principle. Indeed, where the High Court held that possession means "*physical control to the exclusion of others*"(at [45]) it is difficult to understand how an obligation to give physical control of aircraft objects can be satisfied by simply inviting the creditor to take control of them on an "*as is, where is*" basis.

Therefore, it seems likely that important factual and practical issues will need to be resolved in future cases. It remains unclear, however, which, if any, steps would be required in future insolvencies under the "*whatever steps may be necessary*" test. In the way that the High Court applied the test to the facts, it may be that nothing other than a notice disclaiming possession of aircraft objects would be required.

In the absence of clarity, insolvency administrators would be well advised to take on a coordinative role in redelivery of aircraft objects, with a common sense approach to who may bear which particular costs in the circumstances. The most obvious example is for the insolvency administrator to take positive steps to provide all records (probably in digital form). Practical decisions will need to be taken by insolvency administrators whether they need to deploy the airline's technical staff and contractors to assist in that process.

Absent such a common sense approach being adopted by parties, there remains a risk in the future that the coordinative responsibility, that rests with the airline immediately before the time of an insolvency administrator's appointment, with all its records, resources, and safety responsibility, could be suddenly thrust onto a scrum of creditors with divergent interests after the expiry of the "*waiting period*" following an insolvency appointment.

Lessors/financiers should be ready, both when drafting agreements and in practical terms, to robustly assert and exercise Article VIII and X rights to take possession as a fall back absent sufficient cooperation and common sense from an insolvency administrator. Article XII might also assist insofar as it preserves redelivery rights subject to local law stays, which may need to be invoked in particular situations.

The value of Alternative A to aircraft financing and airlines

The Aircraft Protocol is "*integral to lowering the cost and increasing the availability of financing for aircraft equipment*."[3] As noted above, a similar observation was made by the Australian Government when legislating the Cape Town Convention and Aircraft Protocol.

Where the obligation to "*give possession*" is interpreted as merely releasing the creditor from the shackles of a stay under local insolvency law, and otherwise interprets the insolvency administrator's role according to a test with uncertainty as to its scope, "*whatever steps may be necessary to provide an opportunity for the exercise of the right to take possession*," it seems unlikely that Alternative A will offer a significant contribution to lowering the cost and increasing the availability of financing for aircraft equipment. This is particularly so where the impediments under local insolvency law are limited, as they are in Australia.

3 Gray, Gerber & Wool, *The Cape Town Convention aircraft protocol's substantive insolvency regime: a case study of Alternative A* (2016) 5 Cape Town Convention Journal 115 at 123-130

As such, it seems that there is very little work for Alternative A to do in Australia, when viewed as simply removing impediments to the creditor taking unilateral action for possession of the aircraft objects.

The High Court's decision will, therefore, be welcome news for insolvency administrators or debtors seeking to effect a restructure of an airline. For them, the operation of Alternative A will be in line with more conventional notions of the rights of any equipment lessor in an insolvency. In that sense, the decision will reflect the observation of the Full Court of the Federal Court, when it came to a similar conclusion to the High Court, in saying that the Cape Town Convention and Aircraft Protocol does not result in a "*reworking of generally accepted principles of insolvency law*" (at [105]). In particular, the insolvency administrator, for the most part, will not bear the costs of the lessor recovering its property.

It may, however, result in Article XI of the Aircraft Protocol – particularly Alternative A -- falling short of its potential to be regarded as "*the single most significant provision economically*"[4] and specifically, may fall short of achieving its commercial goal of delivering cheaper finance to airlines. If that were the case, the High Court's decision may turn out not to be such welcome news to airlines seeking to lease or finance aircraft equipment.

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4 Official Commentary at [5.60]; cf. Gray Gerber & Wool at 116

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