NORTON ROSE FULBRIGHT

International Restructuring Newswire

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

Q1 2022

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International Restructuring Newswire **is published by Norton Rose Fulbright and is not a substitute for fact-specific legal counsel.**

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Published by Norton Rose Fulbright – Q1 2022 – Issue 16

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To our clients and friends:

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As we move into a new year, it is worth taking a look back at 2021. It was a year marked by the continuing global COVID-19 pandemic that shows no signs of abating anytime soon. The pandemic produced all kinds of stress within the global economic system, ranging from supply chain disruptions, restrictions on businesses, reduced travel, closed borders and general havoc. Paradoxically, despite all of those challenges for business operations, formal insolvency and restructuring proceedings were down significantly in 2021. Per data compiled by Epiq and ABI, in the US commercial chapter 11 filings were down 48 percent during the calendar year from 2020. Consumer filings were also down significantly, by 24 percent.

How to account for the decrease in filings in 2021? There is no one answer, but clearly government relief programs, lender forbearance, low interest rates and ample liquidity in the marketplace all helped businesses weather the storm. Prospects for 2022 may well be different: we are seeing less government relief, rising inflation, continuing supply chain challenges and interest rates rising. Will formal filings trend up in the new year? Time will tell, but do not be surprised if formal filings trend upward.

In the meantime, our new issue will help you stay current on recent developments in restructurings in a variety of jurisdictions around the globe. Of particular interest will be a review of the Steinhoff restructuring, one of the largest in 2021, from both a Dutch and South African perspective.

Good reading and happy new year,

All the best,

Howard Seife
Global Head
Bankruptcy, Financial Restructuring and Insolvency

In the news

John Martin appointed President of the International Insolvency Institute

John Martin, a restructuring and insolvency partner in the firm's Sydney office, was appointed President of the International Insolvency Institute. Having been a Board member of the International Insolvency Institute since 2016, John most recently served as a Vice President. John's appointment as President is a solid testimony to his commitment to the Institute and his standing in the profession, both within Australia and overseas.

The International Insolvency Institute is dedicated to improving international cooperation in the insolvency area and achieving greater coordination among nations in multinational business reorganizations and restructurings. The Institute is a non-profit, limited-membership (by invitation) organization of the most senior and respected practitioners, academics and financial industry professionals in the international insolvency sphere, as well as eminent judges with responsibilities in this field.

INSOL International

Tiziana Del Prete was one of five lawyers invited to join the INSOL Main Organising Committee in connection with INSOL's global conference in London being held June 26-28, 2022. The conference coincides with the 40th Anniversary of INSOL International.

Dutch Scheme (WHOA) Case Law Annotation

Omar Salah was invited to write an annotation on a court order on the Dutch Scheme (Wet homologatie onderhands akkoord, WHOA) for the JOR with case law reference JOR 2022/16. JOR is a leading law review on insolvency and corporate law in the Netherlands.

Journal of the Insolvency Institute of Canada

Luc Morin and Guillaume Michaud authored an article, "Guiding Principles for Distressed M&A Transactions: Choosing the Right Path and the Future of POAs and RVOs," published in the Journal of the Insolvency Institute of Canada, Volume 10.

SARIPA Virtual Conference

November 11, 2021

Scott Atkins spoke at the SARIPA Annual Virtual Conference, discussing the strong partnerships in place between INSOL International and SARIPA and the opportunities ahead for the insolvency profession across Africa.

SMU-Cambridge Roundtable on Corporative Insolvency Law

November 9, 2021

Scott Atkins spoke at the Third SMU-Cambridge Roundtable on "Corporative Insolvency Law: Implementing a Simplified Insolvency Framework for Micro and Small Enterprises." He presented on the insolvency framework for MSMEs in Myanmar, under Myanmar's Insolvency Law 2020 which was drafted by a team from Norton Rose Fulbright, the Union Supreme Court of Myanmar and the Asian Development Bank.

INSOL-World Bank Africa Round Table

November 9, 2021

Scott Atkins spoke at the 12th Annual INSOL-World Bank Africa Round Table on Insolvency Reform (ART), focused on insolvency reforms in Sub-Saharan Africa. He spoke about the immense opportunities for insolvency law reform across the region, and the work INSOL International is doing to support this.

UNCITRAL Working Group V

December 13-17, 2021

Scott Atkins attended the 59th UNCITRAL Working Group V (Insolvency Law) meeting, representing Australia at a series of sessions in December 2021.

California CLE Blitz

January 25-26, 2021

Rebecca Winthrop will speak on a panel on unconscious and conscious bias at Norton Rose Fulbright's January CLE Blitz. The panel will discuss practical considerations and impediments from bias in the courtroom, during arbitrations or in mediations.

Canada's Annual Review of Insolvency Law Conference

February 4, 2022

Three Norton Rose Fulbright lawyers are speaking at the 2022 Annual Review of Insolvency Law Conference. Evan Cobb will speak to his article co-authored with Scott Boucher, "The Plight of the Early Bird: Examining the Pre-Filing Role of the Monitor;" Arad Mojtahedi will speak to his article co-authored with Luc Morin, "Pushing Boundaries: Third-Party Releases in Restructuring Proceedings;" and Jennifer Stam will discuss the Future of Insolvency Practice with the Superintendent of Bankruptcy, Elizabeth Lang.

Steinhoff restructuring: The Dutch suspension of payments as an excellent tool for the restructuring of mass litigation claims

Prof. Omar Salah

The Netherlands played a key role in the global restructuring of the Steinhoff group, which was one of the largest restructurings in 2021. Steinhoff International Holdings N.V. (Steinhoff NV) entered into a Dutch suspension of payments to restructure its debt. In essence, it restructured €14 billion in debt from approximately 66,000 creditors, including mass litigation claimants. This sets a ground-breaking precedent for successful international restructurings of mass litigation claims, which can also be useful for other forms of restructurings involving a significant amount of creditors (e.g., bond debt restructurings).

Background

Steinhoff NV is the Dutch holding company of the Steinhoff group. The Steinhoff group is a retail giant with approximately 90,000 employees in more than 30 countries. Steinhoff NV is incorporated in the Netherlands with its primary listing at the Frankfurt Stock Exchange and its secondary listing at the Johannesburg Stock Exchange. On 5 December 2017, Steinhoff NV announced that the Steinhoff group had been involved in financial irregularities, i.e., serious misstatements in the group's financial statements. As a result, 90% of its share price dropped in value which marked the beginning of a restructuring that would take over four years (and counting) to complete. Shareholders, investors and other stakeholders commenced legal proceedings against the Steinhoff group and its managing and supervisory directors in the Netherlands, Germany and South Africa. Various class-actions were commenced against the group as well. It was estimated that over 66,000 litigation creditors filed claims against the Steinhoff group, setting the scene for a large mass litigation claim.

Initially, the Steinhoff group went through a financial restructuring of €9 billion in debt with its financial creditors. The financial irregularities that were disclosed in December 2017 and the events that ensued therefrom (e.g. massive drop in share price and litigation claims against the group) resulted in various events of defaults under the company's finance documents. The Steinhoff group completed the financial restructuring in 2018 and 2019, using two English law company voluntary arrangements (**CVAs**) as well as a South African law scheme of arrangement. The CVAs and scheme of arrangement provided the Steinhoff group breathing space to restore value and resolve the mass litigation claims against it. As part of the financial arrangements, the Steinhoff group agreed to an extension of certain finance documents to 31 December 2021 and a runway and bandwidth within which it could attempt to settle the claims of the litigation creditors under a global settlement agreement. Subsequently, Steinhoff negotiated with various groups of litigation creditors, D&O insurers and Deloitte (its auditor during the time the financial irregularities took place) to reach a global settlement agreement. However, the extended timeline was not sufficient to complete the global settlement, nor was the bandwidth for settling the claims. Therefore, the Steinhoff group went through another restructuring, which was largely implemented in 2021 and is discussed below.[1]

Restructuring proceedings in multiple jurisdictions

In July 2020, the Steinhoff group announced a global settlement setting forth its initial parameters. In order to effect certain amendments to its finance documents (e.g. extension of maturity date, a larger bandwidth for settling the litigation claims, and lowering the thresholds for future waivers and consents under the finance documents),

1 Various lawyers within Norton Rose Fulbright have been involved in different capacities in the global restructuring of Steinhoff. The author of this article assisted one of the largest creditors of Steinhoff NV in both the 'Dutch scheme' (WHOA) and the Dutch suspension of payments.

Steinhoff promoted a series of consent requests under its finance documents. Certain documents, however, required unanimous consent which was not obtained. In order to, nonetheless, implement the required amendments under the finance documents which were governed by English law, Steinhoff NV commenced an English law scheme of arrangement. Conservatorium Holdings LLC, an investor affiliated to Centerbridge Partners and registered in Delaware with its headquarters in London (**Conservatorium**), opposed the sanctioning of the scheme of arrangement. However, the English court rejected its objection and sanctioned the scheme of arrangement on 5 February 2021.[2]

In the meanwhile, Conservatorium had also commenced a 'Dutch scheme', i.e. a restructuring proceeding under the newly enacted law *Wet homologatie onderhands akkoord* (the ***WHOA***, please refer to the Q1 2020, Q4 2020 and Q2 2021 issues of our *International Restructuring Newswire* for articles on the new Dutch scheme). The new law entered into force on 1 January 2021 and Conservatorium was the first party to file a petition on the first business day of the year, i.e. 4 January 2021, under the *WHOA* to commence a Dutch scheme. Conservatorium requested the appointment of a restructuring expert because, *inter alia,* the formal launch of an insolvency proceeding was taking too long in its view, while at the same time it had doubts about the independence of the managing board of Steinhoff NV given possible ties with and/or undue pressure from the former chairman and shareholder. The Dutch scheme petition has proven to be a trailblazing move of immense strategic significance for circumstances where creditors would like to take action to accelerate a restructuring proceeding. In the restructuring of Steinhoff NV, Conservatorium reached an agreement and settled, resulting in the withdrawal of the Dutch scheme.

Steinhoff NV, in turn, immediately filed for a suspension of payments (*surseance van betaling*) on 15 February 2021, which was provisionally granted on the same date. This marked the beginning of the formal implementation of the global settlement through an insolvency proceeding in the Netherlands. One of the key considerations for the preference of Steinhoff NV for a suspension of payments over a Dutch scheme was that the former would be recognised in Germany, because it was already on Annex A of the European Insolvency Regulation while the latter was not yet.[3]

In addition to the Netherlands and Germany, legal actions were pending in South Africa. The recognition of a Dutch insolvency proceeding in South Africa was (in short:) not possible. However, given that part of the legal proceedings were commenced against Steinhoff International Holdings Proprietary Limited (**Steinhoff Ltd**), a South African entity and the previous holding company of the group, the restructuring also needed to be implemented in South Africa. Hence, a scheme of arrangement under section 155 of the South African Companies Act was commenced to implement the restructuring in South Africa. The Dutch suspension of payments and South African scheme of arrangement were inter-conditional upon each of them entering into force. The South African scheme of arrangement is still ongoing and expected to be completed early 2022. The Dutch suspension of payments, however, was completed in 2021. In the remainder of this article, we will focus on the Dutch suspension of payments.[4]

The Dutch suspension of payments

The Dutch suspension of payments is an insolvency proceeding aimed at the restructuring of a company. In essence, the proceeding is meant to provide the debtor breathing space to prepare a composition plan which it can offer to creditors. A debtor that foresees that it cannot continue paying its debts when due, may request a suspension of payments. The suspension of payments will be granted promptly on a provisional basis, which in practice means that the Dutch court will grant the provisional suspension of payments on the same day or within a couple of days. Further, the court will appoint an administrator whose consent, cooperation or authorisation is required for certain legal acts of the debtor. While it is not mandatory under the Dutch Bankruptcy Act, the court almost always appoints a supervisory judge who supervises the suspension of payments and the conduct of the administrator.

The definitive (i.e., final) suspension of payments is granted at a hearing before the court, unless voted against by (i) creditors representing 1/4th of the value of the debt represented at such hearing, or (ii) creditors representing 1/3rd of all creditors present or represented at such hearing. However, such hearing on the definitive suspension of

2 *Re Steinhoff International Holdings N.V.* [2020] CR-2020-004268 (Ch) (26 November 2020).

3 Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) (the European Insolvency Regulation). Recently, Annex A of the European Insolvency Regulation was changed as a result of the public version of the Dutch scheme (openbare akkoordprocedure buiten faillissement) which has been added to Annex A. Consequently, the public version of the Dutch scheme will be automatically recognized throughout the European Union (EU) under the European Insolvency Regulation going forward.

4 In this issue of the *International Restructuring Newswire*, we cover the Steinhoff saga twice given its international scope. This article covers the Steinhoff saga from the perspective of the Dutch suspension of payment. Our South African colleagues cover the saga and litigation in South Africa.

payments is not required if a composition plan is filed together with the petition for a provisional suspension of payments. In such case, the court will immediately set a date for a creditors' meeting where creditors can vote on the composition plan directly (instead of voting on the definitive suspension of payments first, followed by a separate vote on the composition plan). In practice, debtors often file a composition plan with the day-one petition for a provisional suspension of payments and request the court to set a date for a vote on the composition plan since this provides a debtor a strategic advantage. The composition plan is adopted if voted in favour by (i) a simple majority of all admitted creditors who are present or represented at the meeting, (ii) who together hold at least half in value of all admitted claims. This means that dissenting creditors have a stronger blocking power in a vote on the definitive suspension of payments compared to a vote on the composition plan, which explains why debtors prefer a vote directly on the composition plan.

Once the composition plan is adopted by the creditors, a hearing will be scheduled where the court will confirm the composition plan, unless certain grounds have occurred. The confirmation of the composition plan results in the composition plan being binding an all creditors affected by the suspension of payments (including dissenting, absent and non-voting creditors). However, a suspension of payments – and, as a result, also a composition plan offered in a suspension of payments – only affects unsecured, non-preferred creditors. Under Dutch law, secured creditors and preferred creditors are not bound by the suspension of payments, can take recourse against the debtor's assets during the suspension of payments and cannot be impaired or crammed down under the composition plan. This has been one of the main drawbacks of a suspension of payments in practice and the main reason why it has not been a successful restructuring tool in the Netherlands.[5] In most restructurings, the secured creditors are key stakeholders with a decisive role in making the restructuring successful. The only financial restructurings in the Netherlands where such composition plans have been used successfully were bond debt restructurings.[6] The restructuring of Steinhoff, however, illustrates that a composition plan offered to creditors in a suspension of payments can also be a successful tool for the restructuring of mass litigation claims.

The suspension of payments of Steinhoff NV and the committee of representation

Steinhoff NV petitioned for a suspension of payments on 15 February 2021 – which was provisionally granted on the same day – and filed a composition plan with the request to the court to schedule a vote on the composition plan immediately (instead of a vote on the definitive suspension of payments first), which was granted. One of the complex elements of the Steinhoff restructuring was its creditor base: there were approximately 66,000 litigation creditors based in various countries with claims governed by different legal systems and court proceedings pending in different jurisdictions. Setting up a procedure that would allow all these creditors to participate directly at creditors' meetings, dispute claims of other creditors and vote on the composition plan would have been challenging and complicated.

The Dutch suspension of payments provides a special scheme for restructurings with a large number of creditors called the 'Brandaris-scheme'. NV Assurantie Maatschappij Brandaris (**Brandaris**) was an insurance company with more than 200,000 creditors that suffered distress in the 1960s. The Dutch government introduced a legislative amendment to facilitate its restructuring and introduced the Brandaris-scheme. The Brandaris-scheme provides certain specific rules – which deviate from the standard provisions – for a suspension of payments with more than 5,000 or (for certain provisions to apply) 10,000 creditors, which allow for relief from the court. The most important tool is the ability to appoint a committee of representation (*commissie van vertegenwoordiging*) with at least nine members.[7] A committee of representation should not be confused with a creditors' committee in a suspension of payments or in international insolvency proceedings like US Chapter 11 cases, as the function and role of such committee differs. The appointment of a committee of representation results in creditors losing their individual voting rights; the members of the committee of representation have the exclusive right to vote on the definitive suspension of payments and/or the composition plan. In consideration for creditors losing their individual voting rights, the Dutch legislature introduced a higher threshold for adopting a composition plan: 3/4th of the members of the committee who are present or represented at the voting meeting need to vote in favour of the composition

5 With the entering into force of the Dutch scheme (*WHOA*), a new Dutch restructuring proceeding is available allowing to also restructure secured debt. This is deemed one of the many advantages of a Dutch scheme over a suspension of payments.

6 Some well-known examples of large successful bond debt restructurings using a Dutch composition plan in the Netherlands where the restructurings of UPC, Versatel, Lehman Brothers and Oi. In these cases, Dutch financing vehicles had issued bond debt which was restructured by offering the (unsecured) bondholders a composition plan.

7 Section 281e(1) in conjunction with section 281d Dutch Bankruptcy Act. See also section 281b(2) Dutch Bankruptcy Act.

plan, provided that the quorum requirements for holding such meeting are met (i.e. for the first meeting it is required that 2/3rd of all members are present and, if such quorum is not met, for a subsequent meeting no quorum requirement applies).[8] The Brandaris-scheme was only used once in history: for the suspension of payments of Brandaris only. This changed with the restructuring of Steinhoff NV.

The administrators of Steinhoff NV requested the Dutch court to apply the Brandaris-scheme in the suspension of payments. They proposed a committee with 14 members: members of each (large) creditor group plus four independent members. There is no requirement that all members must be creditors or from a creditor group and, hence, independent members deemed to represent and act in the interest of the creditors may also be appointed. The appointment of a committee of representation was heavily debated and strongly disputed by two creditors. Nonetheless, the court rejected their opposition and granted the request for a committee of representation.[9] As a result, the more than 66,000 creditors did not vote directly, but rather the 14 members of the committee of representation – after various meetings of the committee of representation with elaborate deliberations on the composition plan – voted on the composition plan.

Once the composition plan was adopted, a confirmation hearing was held on 16 September 2021. The court ruled that none of the grounds for rejection applied and confirmed the composition plan.[10] From a Dutch perspective, this marks the end of the suspension of payments, but the plan itself contains a condition precedent that it will become effective once the South African scheme of arrangement has also been sanctioned.

The committee of representation has been an important novelty, albeit based on existing legislation, which was only tested once in practice, as the appointment of the committee of representation streamlined the process and allowed for a resolution mechanism to restructure and settle litigation claims of over 66,000 creditors. The Dutch suspension of payments proved to be of immense significance for settling all claims. The possibility of appointing a committee of representation to streamline the voting process was a material advantage compared to the new Dutch scheme as the *WHOA* does not provide a legal basis in the new Act to appoint a committee of representation – although the *WHOA* does allow for bespoke relief from the court which could open the way for the appointment of a committee of representation in future restructurings. Further, one of the main advantages of the Dutch suspension of payments over more traditional tools for resolving mass litigation claims, e.g., like the Act on the Settlement of Mass Damages Claims in Collective Actions (*Wet afwikkeling massaschade in collectieve actie*, ***WAMCA***) is that it provides for final resolution without an opt-out feature like the *WAMCA*. In order to reach final resolution, the composition plan of Steinhoff NV also stipulated a contractual bar date for submitting claims (i.e., of three months after the plan becoming effective), which was another important novelty as the Dutch suspension of payments does not have a statutory bar date for submitting claims.

The Steinhoff Dutch suspension of payments provides a ground-breaking precedent for settling mass litigation claims and class-actions through insolvency proceedings, making the Netherlands an excellent forum of choice. Needless to say, not all mass litigation claims and class-actions are suitable for resolution through insolvency proceedings and the Steinhoff restructuring has been a peculiar case. However, in situations where mass litigation claims put a debtor on the brink of a bankruptcy, the Dutch suspension of payments provides an excellent tool with the committee of representation being an appealing resolution mechanism to facilitate the process. More importantly, the latter makes the Dutch suspension of payments attractive for global restructurings with a large number of creditors.

The application of the Brandaris-scheme in the Steinhoff restructuring also provides an excellent precedent for bond debt restructuring that involve numerous unsecured bondholders. For example, if different tranches of bonds have been issued, a committee member for each of the tranches may be appointed to represent the bondholders in the committee of representation. The members may also be bond trustees. Bond debt restructurings may be streamlined by a voting procedure where the committee of representation votes instead of individual bondholders. However, existing practice in the Netherlands is to invite the bondholders as beneficial owners to vote directly on the composition plan. It remains to be seen whether the Steinhoff restructuring will change that practice.

8 Section 281e(4) Dutch Bankruptcy Act

9 Rb. Amsterdam 28 May 2021, ECLI:NL:RBAMS:2021:3197

10 Rb. Amsterdam 23 September 2021, ECLI:NL:RBAMS:2021:5452.

Conclusion

The global restructuring of the Steinhoff group has been a fascinating restructuring thus far with multiple proceedings in different jurisdictions. The Dutch suspension of payments of Steinhoff NV has ensured that the implementation of the restructuring has been completed in the Netherlands, allowing for a global settlement with approximately 66,000 creditors consisting of different creditor groups, such as financial creditors and litigation creditors. The application of the Brandaris-scheme was an important tool: by appointing a committee of representation and allowing the members of the committee to vote, the voting procedure was streamlined setting an excellent precedent for large restructurings with large groups of international creditors. This also sets a blueprint for other forms of restructurings like bond debt restructurings with large groups of international bondholders. The Steinhoff restructuring illustrates the importance of the Dutch suspension of payments not only as a restructuring tool, but also as a tool to settle and resolve mass litigation claims and class-actions.

Omar Salah is a partner in our Amsterdam office, in the firm's financial restructuring and insolvency group and Professor of Global Finance & Restructuring Law at Tilburg University in the Netherlands.

Proposed modification of US Bankruptcy Code's fraudulent transfer safe harbor for securities transactions could unsettle LBOs and other M&A transactions

Derek Cash

Citing a need to reform the private equity industry,[1] a group of United States Senators and Representatives have proposed the "Stop Wall Street Looting Act of 2021." If adopted, this new legislation would restrict, among other things, the scope of the Bankruptcy Code's Section 546(e) "safe harbor" provision. The safe harbor protects from avoidance certain securities-related transactions made prior to bankruptcy. Through amendment of the safe harbor, the legislation would open to challenge certain transactions which result in change in control of a target company, particularly those in connection with leveraged buy-outs.

Section 548 of the Bankruptcy Code permits a trustee to undo, or "avoid," transfers of a debtor or the incurrence of obligations by the debtor within two years prior to the filing of a bankruptcy, where the transfer was made or the obligation incurred (i) with the intent to hinder, delay or defraud creditors (an "Actual Fraudulent Transfer") or (ii) where the debtor was insolvent or became insolvent as a result of the transfer, and the transfer was not in exchange for reasonably equivalent value (a "Constructive Fraudulent Transfer").

However, there are several limitations on a trustee's avoidance powers. Of pertinence here, Section 546(e) of the Bankruptcy Code provides a safe harbor for (and exempts from avoidance) payments made by and to financial institutions in the settlement of securities transactions or the execution of securities contracts. Specifically, in its current form, Section 546(e) provides:

> "Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment [...] or settlement payment [...], made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract ..."

The safe harbor provision can promote stability in financial markets by ensuring that securities transactions will not be unwound as the result of a subsequent bankruptcy. For example, in a leveraged buyout ("LBO"), a buyer may fund the purchase of a target company with the proceeds of a loan secured by the target company's assets. The proceeds from the loan are then used by the target company to "buy out" the existing equity holders. Absent the safe harbor protection of Section 546(e), if the target company subsequently files for bankruptcy, the LBO transaction could be subject to avoidance as a constructive fraudulent conveyance on grounds that the LBO transaction rendered the target company insolvent. In such a litigation, the trustee or other estate representative may sue the former shareholders and seek to recover the funds that they received in the LBO.

The safe harbor provision has been subject to significant scrutiny and criticism, including on grounds that it is overbroad and protects more transactions than Congress intended, has failed to achieve its intended goal of reducing systemic risk in financial markets and that it may diminish incentives for parties to properly ration credit and monitor counterparty risk.[2]

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1 See Press Release, Office of Senator Elizabeth Warren, "Warren, Baldwin, Brown, Pocan, Jayapal, Colleagues Reintroduce Bold Legislation to Fundamentally Reform the Private Equity Industry" (October 21, 2021), https://www.warren.senate.gov/newsroom/press-releases/warren-baldwin-brown-pocan-jayapal-colleagues-reintroduce-bold-legislation-to-fundamentally-reform-the-private-equity-industry.

2 See Charles W. Mooney Jr. *The Bankruptcy Code's Safe Harbors for Settlement Payments and Securities Contracts: When Is Safe* Too *Safe* 49 Texas International Law Journal 243, 2014 (summarizing academic critiques of the safe harbor provision).

Recent cases in US federal courts have grappled with the scope of the safe harbor provision, with mixed results. For example, in a 2018 decision, *Merit Management Group LP v. FTI Consulting*, 138 S. Ct. 883, the United States Supreme Court interpreted the scope of the safe harbor provision narrowly, determining that the safe harbor provision did not shield from avoidance securities-related transfers in which the financial institutions that were involved served as mere conduits to the shareholders in the transaction. The transfer at issue in *Merit* involved a purchaser (and subsequent bankruptcy debtor) acquiring the shares of a competitor, with the purchasing funds and shares routed through two banks. The Supreme Court reasoned that courts should consider the nature of the overarching transfer rather than its component parts when determining whether the safe harbor provision applies.[3] Thus, even though financial institutions were involved in the string of transfers by which the purchaser acquired the shares of its competitor, the court considered only the broader transaction (i.e., between the purchaser and the competitor) to determine whether the safe harbor applied. Though not involving an LBO, the case suggested that courts should take a narrow view in determining whether transfers in connection with the purchase of a target company could fall within the safe harbor provision.

3 *Id.* at 897.

In contrast, however, in a decision following on the heels of *Merit*, *In re Tribune Company Fraudulent Conveyance Litigation*, 446 F.3d 66 (2d Cir. 2019), the Second Circuit Court of Appeals held that an LBO transaction was shielded from avoidance because the transaction involved a "securities contract" in which the parties involved were "financial institutions." The transaction at issue concerned a media company's transfer, via a securities clearing agency, of approximately US$8 billion to buy out shareholders. A representative of unsecured creditors of debtor Tribune Company sought to recover amounts paid to Tribune's shareholders in connection with the LBO, on grounds that the price paid for the shares was more than the reasonable value of the company.

The court, however, concluded that the LBO transaction fell within the safe harbor's protections. Specifically, the court determined that the payments made for the purchase and redemption of shares were "in connection with a securities contract," and, notably, that Tribune was a covered "financial institution" under the definition relevant to the safe harbor based on its customer relationship with the bank intermediary which served as the depositary in the transaction.[4]

The *Tribune* decision has been criticized by some as somehow inappropriately expanding the scope of the safe harbor. For example, Professor Daniel J. Bussel, of the UCLA School of Law, contends that it was "simply bizarre to define the statutory term 'financial institution' to include all commercial bank customers," and that the decision results in a "virtual repeal" of any ability to use the Bankruptcy Code to avoid transactions involving securities transfers.[5] Similarly, one court has criticized *Tribune* as a "complete workaround" of the Supreme Court's limits on the safe harbor set forth in *Merit*.[6] However, these criticisms seem to ignore that the Second Circuit followed the statutory language that expressly defined a "financial institution" to include a customer of such institution. The Supreme Court in *Merit Management* did not reach this issue, noting that it was making no decision on definition of "financial institution" since the parties had waived that argument and issue in lower courts. The argument of these critics thus, in reality, is with Congress and the statute.

The proposed Stop Wall Street Looting Act of 2021 would eliminate some of the debate over the scope of the safe harbor exception by removing a broad scope of transactions from the safe harbor's protections. Specifically, the proposed amendment would add language to Section 546(e) to expressly provide that transfers made in connection with a "change in control transaction" are *exempt* from the safe harbor protection. "Change in control" transactions are, in turn, defined to include transactions or a series of transactions that result in a change in the majority ownership of a company's securities or controlling interest. Additionally, the legislation provides that there is a presumption that such a change in control transaction was a fraudulent transfer for a period of eight years from the date on which a change in control transaction closed. The Act would also expand the look back period to eight years for these transactions, rather than the current period of two years. The drafters of the legislation suggest that these revisions will prevent investors from "hobbling the operations" of acquired companies and ensure the companies are able to make investments necessary for future growth.[7]

The immediate prospects for passage of the Stop Wall Street Looting Act of 2021 appear limited given the closely-divided US Congress. Even so, the potential implications of the Act warrant thorough consideration by private equity funds and other financial institutions, particularly those involved in financing LBO acquisitions or other corporate takeover transactions. Specifically, in situations in which a purchaser acquires a target company that subsequently seeks to reorganize under chapter 11, a trustee could (under the legislation as proposed) avoid distributions made to shareholders for the purchase. Given the expansive eight-year "protected period," the Act could inject significant uncertainty into the securities market, as firms face the prospect of the unwinding of purchase transactions closed long ago.

Stay tuned for further developments.

Derek Cash is an associate in our New York office in the firm's financial restructuring and insolvency group.

4 *See id.* at 77-80.

5 Bussel, Daniel J., *Second Circuit Fumbles Tribune on Reconsideration*, Jan. 13 2020. Accessible at: http://blogs.harvard.edu/bankruptcyroundtable/files/2020/01/The-Second-Circuit-Misreads-101.pdf . *See also* Fox, Irina, *Back to Square One: How Tribune Revived the Settlement Payment Safe Harbor to Trustee Avoidance Powers in the Context of Leveraged Buyouts*, 29 N. 4 Norton Journal of Bankruptcy Law and Practice 2, 2020 (characterizing *Tribune* as an "excessively far-reaching" application of the safe harbor)

6 *See In re Greektown Holdings, LLC*, 621 B.R. 797, 827 (Bankr. E.D. Mich. 2020).

7 *Stop Wall Street Looting Act of 2021, S.3022, 117th Cong. § 2(5) (2021)*

Steinhoff in South Africa: How valid is that guarantee?

John Bell

Steinhoff International Holdings NV (SIHNV) and its subsidiaries engaged in the manufacture and retail of furniture, household goods, and clothing. It once operated thousands of stores in over 30 countries, but became embroiled in significant financial irregularities that were uncovered in December 2017.

The Steinhoff saga has resulted in a number of lawsuits instituted against the company, its directors and auditors, both in South Africa and other jurisdictions such as the Netherlands and Germany.

One of these lawsuits unfolded in South Africa's Western Cape High Court, when it recently handed down judgment in the matter of *Trevo Capital Ltd & Others v Steinhoff International Holdings (Pty) Ltd & Others*. The High Court was tasked with interpreting the financial assistance provisions of the South African Companies Act (**the Companies Act**).

The South African Scheme of Arrangement

The genesis of the matter is to be found in a South African statutory scheme of arrangement proposed by Steinhoff International Holdings (Pty) Ltd (**SIHPL**), Steinhoff's South African holding company, to its creditors and in terms of which it sought to settle all claims against SIHPL and its South African subsidiaries (**the Scheme**). The Scheme, in broad terms, makes provision for three classes of creditors (market participant creditors, financial creditors and contractual creditors) and then goes on to propose different settlement terms for claims of the respective classes of creditors. The distinction between the creditors were in large based on the nature and legal basis of their respective claims against SIHPL. The South African Scheme was one part of the overall settlement. The other part was suspension of payments proceedings for the ultimate parent company (SIHNV) in the Netherlands.[1]

Dissatisfied with the proposed terms of the South African Scheme and how the market participant creditors in particular would be treated in comparison with others, certain disgruntled creditors approached the High Court contending that the guarantee-type claims of the financial creditors were based on financial assistance advanced by SIHPL in contravention of the solvency and liquidity requirements provided for in the Companies Act, 2008 and were therefore void. Thus, the challenging creditors contended that the financial creditors were being overcompensated under the Scheme to the detriment of the other classes of creditors.

Section 45 of the Companies Act, 2008

Section 45 of the Companies Act sets out certain requirements that have to be met before a company is permitted to provide financial assistance to a related or inter-related company.

Financial assistance in this context includes lending money (other than in the ordinary course of the company's business), guaranteeing a loan or other obligations and securing any debt or obligation.

One of the requirements for valid financial assistance is that the board directors of the company must be satisfied that, immediately after providing the financial assistance, the company would meet a statutory solvency and liquidity test, i.e. the company's assets must exceed its liabilities and that the company must be able to pay its debts as they become due within the ensuing 12 months (**the Solvency and Liquidity Test**).

In addition the board must be satisfied that the terms under which the financial assistance is proposed to be given are

1 In this issue of the *International Restructuring Newswire*, we cover the Steinhoff saga twice given its international scope. This article covers the Steinhoff saga and litigation in South Africa. Our Dutch colleagues cover the saga from the perspective of the Dutch suspension of payment proceedings.

fair and reasonable to the company and there must also be a special resolution by shareholders in place, passed within the preceding two years, authorising the financial assistance.

Failure to comply with the above requirements renders the financial assistance void.

SIHPL financial assistance

The applicants contended that the SIHPL financial assistance in this particular matter related to the following claims of the financial creditors under the Scheme:

- convertible bonds issued to investors by Steinhoff Finance Holding GmbH (**SFHG**) (a related party to SIHPL) in 2014 with the obligations thereunder then guaranteed by SIHPL (**the 2014 Guarantee**); and
- a conditional payment undertaking (**CPU**) entered into between SIHPL and the same bondholders as part of an English law governed company voluntary arrangement (**CVA**) for certain Steinhoff Group entities, which restructured their debts, following the December 2017 revelations of financial irregularities.

The legal enquiry

The High Court's judgment deals, in the first instance, with the question as to whether: (i) the applicants had standing to bring the application, and (ii) the provisions of section 45 applies to financial assistance being provided to a related company that is a foreign (non-South African) company.

Both the above questions were answered by the High Court in the affirmative. The main focus, however, is on the judgment insofar as it relates to the question whether:

- the Steinhoff board of directors complied with the Solvency and Liquidity Test when they in 2013 (and prior to uncovering of the financial irregularities in December 2017) passed a resolution authorising the granting of the 2014 Guarantee; and
- the CPU constituted financial assistance as contemplated in section 45 of the Companies Act.

2014 Guarantee

On the 2014 Guarantee issue, there was no dispute between the parties that the 2014 Guarantee constituted financial assistance. The disputed issue was whether the board of directors could in the circumstances have been satisfied that the Solvency and Liquidity Test had been met.

The applicants argued that:

- it is now known that, due to the financial irregularities, SIHPL's profits and asset values were significantly inflated over an extended period of time;
- the goodwill and intangible assets reflected in the financial statements were significantly overstated, as was the valuation of certain subsidiary companies, at the time of applying the Solvency and Liquidity Test;
- taken the above into account and based on expert opinions, SIHPL was, in 2013 at the time the resolution was passed, not in a financial position where the Solvency and Liquidity Test could have been met;
- in the circumstances and given the unreliability of the financial statements the SIHPL board, acting reasonably, could not have satisfied itself that it met the Solvency and Liquidity Test – this position being further exacerbated by the fact that both SIHPL's CEO and CFO at the time knew of the irregularities and failed to disclose these at the relevant board meeting.

SIHPL on the other hand argued that:

- at the time that the decision was taken by the board of directors the financial information at its disposal reflected a position that met the Solvency and Liquidity Test;
- in considering the test, reliance was placed on external advisors' opinions;
- there was no evidence at the time that the financial statements and information relied on were unreliable;
- a determination under section 45 must be based on the facts, information and documentation available to it at the time the decision is taken. The test it argued cannot be one founded in hindsight.

The High Court agreed with the applicants that there is a measure of reasonability that must be present in the board's decision. However, in then siding with SIHPL, it criticised the applicant's hindsight approach and "*ex post facto analysis of the company's financial position*" with reference to the accounting irregularities uncovered some three years later. It was held, given the considerations taken into account by the SIHPL board at the time, it cannot be said that the board acted unreasonably in relying on the financial information then before it when approving the financial assistance.

Noteworthy though is that the High Court did not expressly rule the so-called hindsight approach was per se incorrect, but in coming to its decision rather sought to place more reliance on a South African procedural and evidentiary rule. In that regard, the High Court determined that where there is a genuine dispute of fact between the parties, then it must be determined in SIHPL's favour in circumstances where SIHPL's version of events was not untenable or far-fetched. The High Court also held, with reference to the CEO and CFO's knowledge at the time that, given the number of board members, it cannot be validly suggested that the entire board's decision was tainted.

CPU

The CPU issue involved a complex set of facts and legal intricacies that followed the uncovering of the financial irregularities and a call by bondholders on the 2014 Guarantee that SIHPL was unable to comply with.

In very brief and simplistic terms, the failure to abide by its obligations under the 2014 Guarantee resulted in a financial restructuring of SIHPL and the Steinhoff Group which amongst other matters, entailed that the bondholders had their existing debt restated in the CVA pursuant to revised terms:

- The maturity date of the convertible bonds were extended to 31 December 2021;
- The SFHG debt in terms of the bonds were restated or reconstituted on the basis that:
  - the bondholders would extend a cashless loan to a newly formed SIHPL group company, Lux Finco 1, (**the Lux Finco Loan**);
  - the cashless loan proceeds would be on-paid to SFHG who would then in turn settle its obligations towards the financial creditors under the convertible bonds;
- SIHPL and the bondholders would enter into the CPU in terms of which:
  - SIHPL acknowledged its liability as guarantor;
  - SIHPL and the bondholders agreed to the restatement of the indebtedness under the 2014 Guarantee and pursuant to which repayment would be deferred and could not be demanded before 31 December 2021;
  - SIHPL's liability would be capped at an amount equal to the amounts payable under the convertible bond;
  - Payments would be applied to the Lux Finco Loan.

The above terms were reflected in the CVA which, as mentioned, was sanctioned by the English courts.

SIHPL argued in the High Court that the CPU did not constitute new financial assistance in that:

- SIHPL assumed no further debt;
- payments thereunder would only reduce SIHPL's crystallised and existing debt that arose under the 2014 Guarantee;
- the CPU was therefore a mere restatement of the obligations under the 2014 Guarantee.

SIHPL therefore contended that it did not need to have complied with the requirements of section 45 of the Companies Act since the CPU was not a new obligation.

The High Court rejected SIHPL's argument, holding that:

- SIHPL's argument failed to take into account that the restatement of a debt on different terms and conditions and involving at least one different party creates a new debt under applicable South African law.
- There is moreover a distinction between guaranteeing a specific debt and generalized exposure to a certain ceiling or amount of debt.
- The board also cannot authorise financial assistance with reference to the "*financial ceiling of such assistance*", i.e. that the exposure will not be more than previously authorised financial assistance – the board must be alive to the actual or potential recipient and the terms of such assistance that shareholders previously approved.

In taking a substance over form approach, the High Court further held that the CVA resulted in SIHPL's debt under the 2014 Guarantee being discharged with a new debt being created, i.e. Lux Finco's debt under the Lux Finco Loan. The CPU was in turn held to constitute new financial assistance to Lux Finco in that it replaced the 2014 Guarantee and protected the bondholders in the event of a default on the part of Lux Finco under the Lux Finco Loan.

As such, it was determined that the CPU constituted financial assistance and, mindful that it was agreed by the parties that no test under section 45 was conducted at all by the SIHPL board, the CPU was therefore deemed void by the High Court.

Conclusion

The High Court's judgment is of significant importance specifically in the context of a financial restructuring scenario, whether through a scheme of arrangement, business rescue (a South African process to restructure the affairs of a financially distressed company and in which process it was recently held that section 45 does find application) or an informal workout.

The board of a company, business rescue practitioners, investors and financiers must be alive:

- to the requirement that a resolution under section 45 must be reasonable with reference to the facts and information available. A mere tick-box exercise could be found unsatisfactory where information reasonably at their disposal could point to a situation where the tests are not met;
- to the fact that a decision to provide financial assistance is specific to the actual or potential recipient and the terms of the assistance cannot be simply blessed with reference to the fact that it does not exceed an existing "cap or financial ceiling" on debt;
- to considering whether any restructuring of a debt which have arisen through any financial assistance of sorts could result in it being construed and interpreted as creating new financial assistance albeit that the ultimate exposure and the debtor remaining the same. The court's substance over form approach should therefore similarly be adopted in such an assessment.

The judgment remains the subject of an appeal and, mindful of its novel nature and both factual and legal complexities thereof, it is left to be seen whether the South African Supreme Court of Appeal will agree with the High Court.

What would be particularly interesting is how the Court of Appeal will treat an aspect that the High Court did not pay much attention to, namely that the CVA is English law governed, was sanctioned by the English Courts and expressly provides that nothing therein should be construed as discharging SIHPL's liability to the bondholders – a position contradicted by the High Court's judgment that the CVA created a new obligation.

As the judgment did not directly affect the Scheme, it should also be noted that, in the interim period, the Scheme has been approved by the requisite majority of creditors. The Scheme now stands to be sanctioned by the High Court with that application also being opposed by certain disgruntled creditors. It is anticipated that the hearing of this application will take place in the first quarter of 2022.

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Canadian pandemic stimulus programs are now ending – is (economic) gravity about to reassert itself?

Alexander Schmitt

As with so many other things since March 2020, the landscape for Canadian insolvency professionals remains far from normal. Despite an initial flurry of activity as practitioners prepared clients for what was seen as an inevitable tsunami of business failures, not only did the wave not arrive, but insolvency activity levels in general remain at historic lows. Commercial filings fell over 24% in 2020 and hit the lowest levels seen since tracking began in 1987. They have fallen even further since: filings under the *Companies' Creditors Arrangement Act*—the statute of choice for most large corporate proceedings—fell by an astounding 73% for the year ended September 30, 2021 when compared against the equivalent period in 2020. Although this trend was less marked for smaller businesses, bankruptcy and proposal filings—the most common type of insolvency proceeding available to such companies—still fell by 18% during this same timeframe.

Unsurprisingly, it's a complicated picture as to why this is. Businesses have faced numerous challenges during this period, including supply chain difficulties, multiple extended lockdowns and greatly increased debt levels. Increasing inflation may also prove a challenge. However, these factors have so far generally been no match for interest rates at the "zero lower bound" and the willingness of Western governments to provide unprecedented levels of direct stimulus.

In Canada, however, nearly all of the direct stimulus programs for businesses are now winding up. Below, we explore what debtors, creditors and insolvency practitioners can expect going forward.

Crucial supports

Since the beginning of the pandemic, Canadian governments at all levels have offered a wide array of stimulus supports. The most significant for businesses though have been offered federally and have included the following:

- **Canada Emergency Wage Subsidy** (**CEWS**) – provided employers with a substantial subsidy (initially 75% for up to CAD$58,700) on employees' wages where certain revenue declines were experienced. Under this program, approximately CAD$98.6 billion has been spent to date on 457,000 approved employers.
- **Canada Emergency Business Account** (**CEBA**) – provided loans of up to CAD$60,000 to small businesses, and that would have the balance forgiven if 66% is repaid by December 31, 2022. To date, CAD$49.2 billion has been approved under the program for 898,000 applicants.
- **Large Employer Emergency Financing Facility** – provided bridge financing for large employers with minimum annual revenues of CAD$300 million at loan amounts of CAD$60 million or more.
- **Canada Emergency Rent Subsidy** (**CERS**) – provided a subsidy to qualifying business for commercial rent and mortgage expenses in a monthly amount of up to CAD$75,000 per location (for four locations total). Approximately CAD$7.4 billion has been spent to date on 218,000 approved applicants under the program
- **Highly Affected Sectors Credit Availability Program** – provided heavily-impacted businesses (primarily tourism, hospitality and restaurants) with guaranteed, low-interest loans of between CAD$25,000 to CAD$1 million to cover operational cash flow needs. Approximately CAD$2.4 billion has been provided to date.
- **EDC Loan Guarantee for Small and Medium-Sized Enterprises** – via Export Development Canada, this guaranteed 80% of new operating credit and cash flow term loans in amounts of up to CAD$6.25 million.

- **BDC Co-Lending Program for Small and Medium-Sized Enterprises** – via Business Development Canada, this provided co-lend term loans of up to CAD$12.5 million to small and medium sized-enterprises for operational cash flow requirements.
- **BDC Mid-Market Financing Program** – via Business Development Canada, provided junior loans of between CAD$12.5 and CAD$60 million to medium sized businesses.
- **EDC Mid-Market Guarantee and Financing Program** – via Export Development Canada, this brought liquidity to companies with revenues between CAD$50 and CAD$300 million. Separately also provided guarantees of up to 75% of new operating and cash flow loans between CAD$16.75 and CAD$80 million.

The impact of these programs has been immense. As mentioned to above, insolvency filings have fallen across the board during the pandemic. But perhaps the best illustration of their impact is that filings fell substantially even for particularly hard hit sectors like hospitality, tourism and restaurants. Although this is surely clouded by instances where businesses have ceased operating but didn't formally file for bankruptcy, it also makes sense. For many of the businesses that were most acutely affected by the pandemic, wages and rent were their biggest operating line items, and so programs like CERS and CEWS went a long way in assisting them.

Programs winding up

Each of the above-noted stimulus programs has now closed out however—with the substantial majority of them shuttering to further applicants on December 31, 2021. The exceptions to this rule are the CERS and CEWS programs, which the Federal government has proposed to extend through to May 2022.

In both cases however, they would be subject to major changes that will narrow and dampen their impact. First, the programs would be available only to tourism, hospitality and certain other hard hit businesses that meet large (up to 50%) revenue loss thresholds; and second, their subsidy rates would be cut in half from March 2022 onwards. At CAD$7.4 billion, the total estimated cost of these additional measures also represents a small fraction of what has been spent under prior programs.

Uncertainty ahead

What the ending of these programs means going forward for insolvency activity levels remains unclear. As of the time of writing, many economic indicators remain very positive, and over 80% of eligible Canadians have received two doses of a vaccine.

On the other hand, serious challenges remain. This includes the threat of inflation but also the fact that many business have taken on substantial amounts of debt just to survive to this point, much of which will be repayable in the relatively near term. Loans under the CEBA, for instance, one of the largest stimulus programs at CAD$49 billion, will come due at the end of 2022.

Finally, there is now the threat of the Omicron variant, which has thrown a wrench into everyone's best-laid plans. If it impacts economic activity as forcefully as early signs suggest (as at the date of writing, in late December 2021, it's already causing lockdowns and curfews in Quebec, Canada's second most-populous province), it may well prompt a renewal of these now shuttered programs.

Either way, many businesses and their lenders would do well to monitor the situation and their cash very carefully. Any renewed stimulus is likely to be more limited in scope than previously offered, and as mentioned, other challenges remain. Although many companies have done very well to weather the storm so far, the next few months are likely to be crucial as many of the hardest hit businesses see if they can stand on their own two feet. Given how important many of these supports appear to have been for some of the hardest-hit sectors, it may well be that this is finally when economic "gravity" reasserts itself and insolvency activity levels start to tick up again.

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Valuations: A UK perspective

Manhal Zaman

In this article, we discuss the heightened importance of valuations in UK restructuring scenarios and, in particular, how the valuation issues played out in the 2021 *Virgin Active* restructuring plan.

Background

Valuations have long been a sticky subject in many financial restructuring transactions — the value of the assets that are the subject of competing claims will frame the negotiations and form a base for the restructuring proposals.

Creditors (or shareholders) whose claims are "out of the money" (i.e. the value of the business is such that the creditor will have no recovery based on the relative creditor lien(s) and other priorities) can find themselves subject to a procedure (or the threat of a procedure) that, while saving the business as a going concern, sees valuable assets (and therefore, potential for future recoveries) moved out of their reach. Stakeholders often commission competing valuations with differing methodologies in the hope of obtaining the best possible outcome for themselves.

This is what happened in *IMO Car Wash*[1], a landmark 2009 case involving a substantial valuation dispute. In this case, the debtor group and the senior creditors sought to exclude the mezzanine creditors from a debt-for-equity swap on the basis that the going concern value of the business broke above the mezzanine debt (i.e. that the mezzanine creditors were out of the money). The debtors' valuation was based on various methodologies, including discounted cash flows and multiples in transactions involving the sale and purchase of similar businesses in the same sector as the group. This valuation was contested by the mezzanine creditors on the basis that it did not reflect the economic climate and the lack of relevant transactions in the sector from which to draw comparisons. The mezzanine creditors carried out their own analysis based on projected future cash flow in a number of simulations generated by a computer model to show the "intrinsic value" of the business and a potential return to the mezzanine creditors. The court found in favour of the "real world assumptions" of the debtors' valuation, noting that: *a proper approach to valuation in a case such as this requires some real-world judgments as to what is likely to happen… rather than a range to which other ranges are applied in a series of random calculations to come up with some mechanistic probability calculation*.

The restructuring plan's "relevant alternative" and valuations

In 2020, the UK introduced a new restructuring plan to its statutory restructuring procedures. The new restructuring plan (in Part 26A of the Companies Act 2006) is similar to a scheme of arrangement, but "super-charged" with the potential for a company to cram down dissenting creditors across classes and ignore "out of the money" creditors that do not have a genuine economic interest in the company.

The cross-class cram down is available where 75% (by value) of one class vote in favour of the plan, and no member of the dissenting class would be any worse off than they would be in the event of the "relevant alternative" (being whatever the court considers would be most likely to occur in relation to the company if the plan were not sanctioned). This test requires first an assessment of the relevant alternative, and then an assessment of the likely returns in that relevant alternative compared to the likely returns if the plan was sanctioned.

The importance of the valuation in this test (and therefore the potential for dispute) is clear. As noted by Snowden J in his judgment in the *Virgin Active*[2] case:

> *…the possibility of the Part 26A regime giving rise to valuation disputes was foreshadowed in [the Government's] response to the outcome of its consultation on "Insolvency and Corporate Governance" published on 26 August 2018: "Many respondents noted how contentious valuation can be…. The Government acknowledges that disputes over valuation may result in costs and delay to restructuring plans being confirmed or not. The responses received indicate that it is highly unlikely that any standard chosen would completely remove the potential for dispute given the importance of the valuation in determining who may be crammed down."*

1 *Re Bluebrook Ltd* [2010] BCC 209

2 *Re Virgin Active Holdings Ltd* [2021] EWHC 1246 (Ch)

Virgin Active - dissenting creditors are no “worse off” and key takeaways for valuations in future restructuring plans

In *Virgin Active,* the gym and leisure group proposed a restructuring plan to compromise its leasehold liabilities. This was the first restructuring plan to seek court approval to cram down dissenting landlords; prior to the introduction of the restructuring plan, the statutory procedure commonly used by companies to achieve such ends was a company voluntary arrangement. In the current case, the leases were split up into five classes based on profitability/value – those in classes A and B (the most valuable and those the group was keen to retain) being treated more favourably than those in classes C, D, and E (the less valuable). Amongst the landlords, only the class A landlords voted in favour of the plan. The dissenting landlords objected to their treatment at the sanction hearing.

The relevant alternative put forward by the group was an insolvency procedure (administration) in which the secured creditors would fund an accelerated sale process of certain valuable parts of the group. The group valuations were carried out on a going concern and debt-free basis, and assumed a willing buyer and a willing seller would be found for an orderly sale. The valuations did not account for circumstances which might have adversely affected the value achieved on a sale (such as the requirement for the sale to take place on an accelerated basis in an administration), and so a distressed discount was applied when considering the valuation required to see the dissenting landlords receive a return.

In a May 2021 decision, Snowden J provided a helpful framework which will be of use when considering valuation issues in this context going forward:

1. **Market testing is not mandatory:** the valuations provided by the group were desktop valuations carried out on a discounted cash flow basis and cross checked against other valuation methods and forecasts. The dissenting landlords argued that a market testing process should have been conducted to value the plan companies’ assets. The court found there was “no absolute obligation” in legislation or otherwise, to conduct a market testing process as part of the process. Snowden J noted there is no evidence that market testing is “habitually” used (as argued by the landlords) and it was unclear how funding for such a process would have been obtained. Finally, it was noted that the outcome of any market testing would have had to be treated with “extreme caution”, given it involved a gym and leisure business in an already depressed market when most of the sector was closed as a consequence of COVID. This gives companies considering a restructuring plan the comfort of knowing that there is no requirement to test the market before proposing the plan.

2. **The sophisticated creditor**: the dissenting landlords argued that the evidence before the court was not the best evidence it might have had if the plan companies had conducted the process differently, particularly given difficulties accessing information (some of which was delivered late). The court didn't agree and held that the dissenting landlords had been provided with sufficient information to analyse the proposal. Snowden J noted that the dissenting landlords were "sophisticated commercial parties" who had instructed "sophisticated advisers" and that all parties had been operating "to a compressed timetable in a matter of real urgency". The fact that only one formal valuation existed was because the dissenting landlords had failed to put forward their own. One could say this was the main reason the dissenting landlords failed – had they adduced their own valuation evidence showing a higher value, the outcome may have been different.
3. **Unreliable valuation evidence**: the dissenting landlords argued that there was uncertainty in the underlying valuation evidence put forward by the plan companies, specifically that the multiples and calculations were flawed. Again, the court was not sympathetic to these arguments, noting that valuations will inevitably produce a range of possible outcomes and it is for professional advisers to show what is most likely to occur under the circumstances from those outcomes. As above, dissenting creditors should think twice before going on the attack without strong alternative evidence in hand.
4. **The court doesn't want lengthy disputes:** Snowden J considered the above-mentioned government consultation and reminded parties that the restructuring plan and the process generally was aimed at protecting the rights of dissenting creditors by ensuring that they were "no worse off" than the relevant alternative. The existence of different valuation methodologies resulting in lengthy disputes should not undermine the fundamentals of a plan. The court expects companies to cooperate with their creditors in a timely fashion and provide adequate information with the aim of efficient resolution of "genuine valuation disputes".
5. **"Out of the money", out of luck**: as counsel for the dissenting landlords put it: "*if you are not sitting at the table, that is because you are lunch*". In the money creditors remain in a strong position to drive through a restructuring transaction with the debtor without significant (if any) input from out of the money creditors. The out of the money creditors (in this case, the dissenting landlords) carried little to no weight on the outcome of the plan – the court noting that it should be for those with an interest in the "restructuring surplus" to drive the procedure and decide on the allocation of value.

The relevant alternative isn't always an insolvency process

In another landmark case heard in June 2021, *Re Hurricane Energy*[3], the High Court declined to sanction a debt for equity restructuring plan proposed by the company and supported by its bondholders that sought to cram down the existing shareholder class and dilute their holding to 5%. Unlike *Virgin Active*, the relevant alternative here was not an insolvency procedure, but continued trading. The court found that there was a realistic prospect that the company would be able to discharge its obligations to bondholders, thereby leaving assets with at least potential for exploitation, and this was sufficient to refute the contention that the shareholders would be no better off under the relevant alternative than under the plan.

Conclusion

The *Virgin Active* case has given practitioners clear and helpful guidance on the use of valuations in restructuring plans. It is hoped that this guidance will assist parties in agreeing their financial restructuring transactions without lengthy (and costly) valuation disputes. However, where a dispute is looming, sound alternative valuation evidence is vital to protecting the position of dissenting creditors.

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3 *Re Hurricane Energy plc* [2021] EWHC 1759 (Ch)

German Shareholding as a Service - An opportunity for deconsolidation of non-core assets through involvement of a professional restructuring shareholder

Dr. Sylwia Maria Bea, David J. Schrader

The current global market has been exposed to various transformative developments and industry consolidation for some time. Depending on the industry, short-term, but far-reaching crises, such as supply chain disruptions, are negatively impacting firms. This comes on top of transformations such as digitalization and electrification (especially in the automotive sector) that are leading large corporations, in particular but also private equity companies, to look for ways to shed less profitable and crisis-prone assets.

Historically, non-core and less profitable entities or assets have usually been separated from the healthy core business of a group by means of a carve-out of the distressed assets or business units. The downside of the carve-out, however, is that the legacy debts commonly remain on the enterprise's balance sheet, and the financial situation of the group as a whole remains impaired. On the other hand, if completely separated, the shareholders may lose control over the carved-out assets or business unit, for example where it is sold to investor third-party.

What is the Shareholding as a Service model?

Against this background, a new restructuring model in Germany called "Shareholding as a Service" (**ShaaS**) offers a different path with continued opportunity for investor recovery. ShaaS focuses on separating the core business from the distressed non-core assets by transferring them - if possible at book value - to a "restructuring shareholder", which leads to a short-term deconsolidation and reduction of liability and risk. The special feature of ShaaS, however, is the ability to also retain full control over the non-core assets in accordance to the regulations of a corresponding restructuring agreement between the existing owners and the restructuring shareholder. The appointed restructuring shareholder acts on its own behalf (subject to the terms of the restructuring agreement) and the carve-out transaction can be communicated externally as the final sale of the non-core assets.

How to prepare and assess Shareholding as a Service?

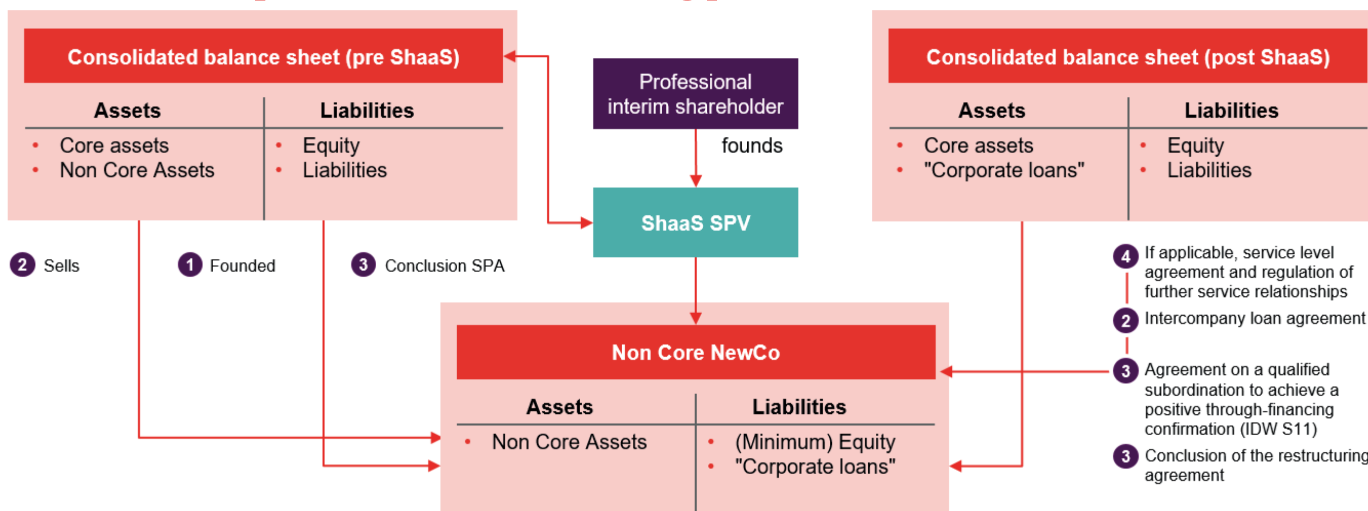
The main prerequisite for the successful implementation of the ShaaS model is precise due diligence and determination of the object, its products, sites, employees and other value-creating factors, as well as third-party liabilities and financing requirements. Previously used group services and service relationships of the object must be identified and a decision taken as to which of these will remain in place. Change of control clauses and the existence of collateral in the contractual relationships with customers and external financiers may be decisive in this respect. Furthermore, cash pools have to be dissolved and intragroup clearing accounts will be frozen. Based on the findings of the due diligence, a corporate structure must then be developed that enables the most advantageous implementation of ShaaS, also taking into account tax law aspects. Typically, the object will first be transferred within the group into a separate legal entity, e.g. a NewCo, via an intercompany asset deal at book values. In order to reduce risk, it is advisable to appoint a restructuring management team, in particular a CRO to support the group in implementing the steps outlined. As a further preparatory step, it is also necessary to prepare a business plan. Based on this plan, the financing needed can be derived and, if necessary, communicated to the external financiers. However, generally a shareholder loan will be granted to ensure that the process is adequately financed.

What could be the possible structure of this restructuring model?

Starting from there, the restructuring shareholder takes over the – possibly over-indebted – NewCo via share deal for a symbolic purchase price. For this purpose, an SPV may be established that holds the shares of NewCo for the purpose of restructuring.

In order to ensure a successful process and thereby prevent the object from becoming insolvent, the transaction will be secured by appropriate measures. Quite commonly, the group will agree to a qualified subordination agreement for the shareholder loan. This will enable a positive financing confirmation for the entire process. In addition, the purchaser's concept can be confirmed by an expert opinion, in accordance with the IDW-standard 11, showing the non-existence of over-indebtedness or illiquidity and thereby ensuring that there is no legal obligation to file for insolvency according to German insolvency law. The granting of collateral by the group is another way to secure the object accordingly. After successful implementation of the ShaaS, the acquisition can be communicated externally as the final purchase of the non-core assets by the restructuring shareholder.

Shareholding as a Service (ShaaS) for the desonsolidation of non-core assets with the involvement of a professional restructuring partner



What about the restructuring governance and exit scenarios?

The main advantage of the ShaaS model is the continuing control over the NewCo. The control can be exercised, for example, by an appointed advisory board to monitor the restructuring on behalf of the former shareholder and to influence decisions of the restructuring management. The CRO, who assumes operational responsibility, will report regularly to the advisory board as part of the common reporting structures during the restructuring. The details of these structures can be customized individually to meet respective requirements and needs of the parties involved, whereby the repayment of the shareholder loan will usually be one of the main objectives. Whether the old business model can be developed into a sustainable future business model and NewCo subsequently sold at a profit, or whether it is more appropriate to continue with the old business model after undergoing a performance-related restructuring and subsequent sale, depends on the specific economic and legal situation. Alternatively, the winding-up and leveraging of synergies can also be a useful mean of generating economic success.

What opportunities arise for the parties involved in a Shareholding as a Service?

Opportunities for private equity companies

For private equity companies in particular, the ShaaS model provides new business opportunities. Depending on the scenario, the private equity company either can make use of the ShaaS-model by restructuring loss-making investments through involvement of a professional restructuring

shareholder or, alternatively, invest into the company, which has undergone restructuring in accordance to ShaaS. While the group is relieved of liability and risk, it still retains control over the NewCo, the private equity companies contribute to increasing the value of the company by sharing their expertise, thereby increasing their own profit. Furthermore, if a buyback agreement is envisaged, there is also no need for the often-lengthy search for a buyer after a successful turnaround.

Opportunities for the company and the Group

Outside of a ShaaS, the affected group consisted of both profitable assets on one hand and loss-makers on the other hand. Under the ShaaS procedure, a comprehensive separation of the economically unstable non-core asset from the core group can be achieved. The financial structure and debt leverage of the group will be adjusted to fit the future core business' capacity. The sale of the risky subsidiaries or assets and the granting of the shareholder loan will result in deconsolidation of the object. If the restructuring proves to be successful, the group will now be able to continue with an adjusted balance sheet in the long term. The credit rating of the group and its core business will improve.

Opportunities for shareholders

Shareholders who granted shareholder loans to the NewCo have a significantly higher probability of repayment. Further, the shareholders benefit economically from an increased value of the non-core assets or business as a result of a successful restructuring. In addition to the economic opportunities, the medium to long-term reduction of risk, while retaining control, has a positive effect in every way. Liability and risk, which could previously arise from capital maintenance regulations, are significantly reduced or even excluded.

Effects on the balance sheet

The structural advantage of ShaaS is the deconsolidation of non-core assets from a group`s balance sheet while retaining control for the group. Considering the balance sheet of the NewCo (see picture above), the assets are transferred onto the SPV (at book values) as well as liabilities resulting from the shareholder loan. With the consent of the contracting party, other legacy obligations and liabilities can also be severed and transferred to the NewCo. However, a possible over-indebtedness and therefore insolvency risks can be mitigated by the above-mentioned subordination agreement. The group will henceforth be the main creditor of the NewCo and the shareholder loan will be accounted for in the annual and consolidated financial statements.

Liability

Risk for existing shareholders, which may arise from capital maintenance regulations or other liability, cease to apply in a ShaaS model. This is also true for liability risk for the current management. Generally, management may be held civilly liable with their personal assets at risk, but also may be liable under criminal law, when the provisions of the German insolvency laws are not strictly followed. When applying the ShaaS model, however, liability risk for shareholders and management are transferred to the restructuring shareholder and the restructuring management. Any risk for the restructuring shareholder and restructuring management, can be mitigated by means of an experienced CRO with substantial expertise in the restructuring area.

Summary

The ShaaS model represents a target-oriented alternative for those who wish to separate a loss-making business unit or asset from the group through deconsolidation, but without losing control. ShaaS also represents a way of ensuring risk reduction for the existing shareholders and management. In addition, private equity companies can benefit in several scenarios from the reorganization, while the financing requirements are fully covered by the group, which might substantially pay out if the reorganization is successful. All in all, ShaaS therefore represents a serious alternative in the field of corporate restructuring that is worth considering for all parties involved.

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