NORTON ROSE FULBRIGHT

International Restructuring Newswire

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

Q4 2024

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To our clients and friends

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Published by Norton Rose Fulbright – Q4 2024 – Issue 27

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To our clients and friends:

To our friends and clients:

Welcome to our fourth quarter issue of the International Restructuring Newswire, where our lawyers from around the globe share their insights on issues facing all of us in the restructuring realm. Directors, for example, need to be particularly cognizant of their duties when the companies they serve are facing financial distress. These duties may well shift depending on the status of their company and the demands of creditors and other stakeholders. We take a close look at the dilemmas facing directors in two key jurisdictions—England and Singapore—and report on critical new key decisions coming out of the courts that should guide directors' actions. We also examine critical new trends in the cross-border restructuring world: the use of the Netherlands WHOA in conjunction with a Part 26A UK restructuring plan; the new wave of liability management transactions (LMTs) in the US; and the growing dominance of private credit in the global market.

Good reading!

Howard Seife
Global Co-Head of Restructuring
New York

Scott Atkins
Global Co-Head of Restructuring
Sydney

In the news

Prof. Bob Wessels and Prof. Omar Salah co-author new book on the Dutch WHOA

Prof. Bob Wessels and Prof. Omar Salah co-authored a new book on the Dutch WHOA (also referred to as the "Dutch Scheme"). The book is announced by other academics and experts as "expectedly the leading textbook on the Dutch WHOA". The book titled "Outside Bankruptcy and Suspension of Payments" will be known as "Wessels-Salah Insolventierecht IX 2024" and forms Book No. 11 in the Wessels Series on Insolvency Law.

The official book launch took place on September 12, 2024 at an event of the Dutch Restructuring Association (*Nederlandse Vereniging voor Herstructurering*, NVvH) in Amsterdam, the Netherlands. The first copy of the book was handed over to Prof. dr. Frank Verstijlen (Vice-President of the NVvH) by the authors Prof. dr. Bob Wessels (Emeritus Professor of International Insolvency law, University Leiden) and Prof. dr. Omar Salah (NRF Restructuring Partner in Amsterdam and Professor of Global Finance & Restructuring Law, Tilburg University).

American Bankruptcy Institute (ABI) 40 Under 40

Julie Goodrich Harrison (Houston) has been named to ABI's 2024 Class of 40 Under 40, a distinguished list of top young bankruptcy and insolvency professionals who demonstrate remarkable ability, leadership and achievement across the industry. The ABI is the largest multi-disciplinary, nonpartisan organization dedicated to research and education on matters related to insolvency with a membership of nearly 10,000 bankruptcy professionals.

American College of Bankruptcy

Scott Atkins (Sydney) was invited to become a Fellow in the American College of Bankruptcy's 36th class of inductees. The College consists of over 800 Fellows, each recognized for their professional excellence and exceptional contributions to the bankruptcy and insolvency practice. Scott and his class will be inducted into the College at a formal ceremony in March 2025 in Washington, DC.

Insolvency Institute of Canada

Guillaume Michaud (Montreal) was recently admitted to the Insolvency Institute of Canada (IIC). The ICC is Canada's premiere private sector insolvency organization. A non-profit organization, the IIC is dedicated to improving the insolvency process and enhancing the professional quality of, and public respect for, the insolvency and bankruptcy practice in Canada.

Turnaround Management Association Australia - Annual Conference

September 10–11, 2024

Laura Johns (Sydney), together with Richard Hughes from Deloitte and Joseph Hansell from FTI Consulting chaired the 2024 Turnaround Management Association Australian Conference. The conference was attended by over 300 national and international delegates in Sydney, Australia. Norton Rose Fulbright sponsored the Network of Women breakfast as part of the conference program which was hosted by Jenna Scott-Speyers (Brisbane) and Kellie Link (Perth).

2024 CAIRP Insolvency & Restructuring Exchange Conference

September 23, 2024

Jennifer Stam (Toronto) spoke at the 2024 CAIRP Insolvency & Restructuring Exchange Conference in Toronto. Her panel spoke on the complexities of assessing distressed situations and developing effective restructuring strategies, drawing on recent cases and industry trends.

Forum on Asian Insolvency Reform (FAIR)

September 26–27, 2024

Scott Atkins (Sydney) attended the INSOL International and The World Bank Group's Forum on Asian Insolvency Reform which was hosted by the Ministry of Law of Singapore.

Insolvency Institute of Canada Conference

September 26–29, 2024

Jennifer Stam and Evan Cobb (Toronto) spoke at the annual conference for the Insolvency Institute of Canada in Scottsdale, Arizona. Jennifer's panel topic was "Dual Corporate Personalities – Now You See One, Now You Don't." Evan's panel topic was "Do You 'Siriusly" Trust US?"

INSOL Europe Annual Academics Conference

October 2–5, 2024

Prof. Omar Salah (Amsterdam) was invited to speak at the Academics Forum at the annual conference of INSOL Europe in Sorrento, Italy. He joined a panel on "Cross Border and International Insolvency" where he presented on "Parallel Proceedings in Cross-Border Restructurings".

INSOL International Seoul Seminar

October 7, 2024

Scott Atkins (Sydney) chaired a panel at INSOL's seminar in Seoul, South Korea. His panel, "Cross- Border Chronicles," was an engaging session which explored the complexities of cross-border matters in insolvency, focusing on the legal and practical obstacles encountered when seeking international recognition. Through the use of illuminating case studies, the expert panel navigated issues such as jurisdictional conflicts, recognition of foreign proceedings, coordination among multiple jurisdictions, and enforcement of judgements across borders.

Debtwire Forum Asia Pacific 2024

October 10, 2024

Scott Atkins and Alex Mufford (Sydney), and Meiyen Tan and Beelee Seah (Singapore) attended Debtwire's annual conference in Hong Kong. The forum was attended by over 800 leading credit professionals from across the region for a day of interactive panel discussions, thought-provoking presentations, and exclusive networking. The event provided attendees with insights into the latest trends and opportunities available for those pursing credit strategies in the region.

43rd Annual Jay L. Westbrook Bankruptcy Conference

November 21–22, 2024

Julie Harrison (Houston) will be a panellist at the annual Jay L. Westbrook conference in Austin, Texas. The panel will discuss the comparisons and contrasts of procedures for complex Chapter 11 cases across the districts.

ABA Air & Space Law Forum's Aircraft Finance Conference

December 4, 2024

David Rosenzweig (New York) will be speaking on a panel discussing the SAS cross–border restructuring at the ABA Air & Space Law Forum's Aircraft Finance Conference in New York.

Directors' duties in hard times: When exactly do directors' duties shift from acting in the best interests of the company as a whole, to acting in the best interests of its creditors?

The company's financial state is the determinative factor. A 5-Judge Bench of the Singapore Court of Appeal provides clarity in *Foo Kian Beng OP3 International Pte Ltd* (in liquidation) [2024] SGCA 10.

Meiyen Tan and Hannah Alysha

Introduction

Every director has a duty to act in the best interests of his or her company. But how are the best interests of a company, an inanimate legal person, to be understood? Further, which stakeholder's interests (i.e. company's shareholders, the creditors or the employees) take precedence at any given point in time?

As elegantly put by the Singapore Court of Appeal in *Foo Kian Beng OP3 International Pte Ltd (in liquidation)* [2024] SGCA 10 ("***Foo v OP3***"), there is no "single and unchanging answer."

The interests of the company and all its stakeholders row broadly in the same direction when a company is in the pink of health. Indeed, there is little reason for a divide where a company is thriving and can pay its employees, distribute dividends to shareholders *and* repay their loans to creditors on time. The interests of creditors are sufficiently protected, and directors may be entitled to treat the interests of shareholders as a sufficient proxy for those of the company.

Time and time again however, we have seen a drastic divergence in the interests of these various stakeholders when a company's financial position weakens:

i. The management can be tempted to make risky "bet-the-company" deals in an attempt to improve the company's financial position.

ii. Shareholders (who may also include management) may on the other hand, be inclined to extract as much value from the company before an impending collapse.

iii. Finally, there are the creditors who are determined that there should not be any non-essential outflows from the company or even any further trading at all, because these would eat into the company's estate.

The position across the Commonwealth countries is consistent: when a company is on the brink of insolvency, the interests of that company's creditors come to the fore, and a director's duty to the company's creditors becomes his pre-eminent duty (the **Creditor Duty**). The shift lies in who may be said to be the main economic stakeholder of the company and the asymmetry in corporate governance:

i. Shareholders are the primary bearers of the risk of loss arising from the exercise of directors' duties when a company is solvent.

ii. When a company is insolvent however, creditors become the primary bearers of the risk of loss because an insolvent company effectively trades and conducts its business with creditors' money. At the same time, these creditors have no control over the conduct of the company's business.

Justice therefore, tips its scales in favour of creditors when a company falls on hard times. After all, shareholders usually have nothing to lose and everything to gain, and creditors, contrastingly, have everything to lose and nothing to gain by the continued trading of a company which is on the cusp of insolvency.

What has always been less clear, however, is this: **when exactly does this shift take place?** What is the inflexion point at which the Creditor Duty comes to the fore? Up until recently, the courts across the Commonwealth had not been uniform in describing when the Creditor Duty first arises. Vague and ambiguous terms such as "bordering on insolvency" and "financially parlous" were used as thresholds, leaving directors *and those who advise them with uncertainty.*

The parameters of the Creditor Duty was thoroughly considered by the Singapore Court of Appeal in ***Foo v OP3*** as we elaborate below.

Facts

Foo was the sole director and shareholder of OP3, a construction company. OP3 was engaged, sometime in 2013, to provide construction services to a company running dental clinics (**Smile Inc**). OP3 and Smile Inc eventually ended up in a legal dispute over the services rendered by OP3. Amongst other things, Smile Inc alleged that the construction works conducted by OP3 led to the growth of mould and the flooding of its clinic.

In May 2015, Smile Inc sued OP3 for damages of S$1.8 million. While these proceedings were ongoing, Foo (as the sole director of OP3) caused OP3 to: (i) pay him dividends; and (ii) repay his shareholders loans (collectively, the **Impugned Payments**). As a result, OP3 paid a total of S$2.8 million to Foo between December 2015 to 2017.

OP3 was found to be liable for damages to Smile Inc by way of a decision of the High Court rendered in October 2017. These damages were subsequently quantified to be in the sum of S$534,189.19 in a decision handed down in November 2019.

OP3 failed to satisfy the debt owed to Smile Inc and was wound up on 3 April 2020. A liquidator was appointed, and in February 2021 an action was commenced in OP3's name against Foo to recover the Impugned Payments. Amongst other things, the liquidator alleged that in authorizing such payments to himself, Foo had breached his duty to act in the best interests of OP3 because OP3 was already in a financially parlous position at the time.

Foo's position was that the Creditor Duty was *not* engaged at the time, because OP3 was not in fact insolvent or on the brink of insolvency when he authorized the Impugned Payments. Amongst other things, he also argued that his contingent liability arising from the lawsuit commenced by Smile Inc need not have been accounted for as this liability was not one that was likely to materialize.

The crux of the dispute thus centred on whether the Creditor Duty was engaged at the time Foo authorised the Impugned Transactions.

First instance decision of the High Court

The High Court determined that the Creditor Duty was engaged when the Impugned Payments were authorized by Foo, as OP3 was in a "financially parlous" state. Even though OP3 was technically solvent at the time, the contingent liability arising from the lawsuit commenced by Smile Inc had to be accounted for because Foo could not have reasonably believed that OP3 would not face *any* liability in the lawsuit. Taking this contingent liability into account did in fact place OP3 in a financially parlous state.

Accordingly, the Creditor Duty arose; Foo had an obligation to consider the interests of OP3's creditors as part of his fiduciary duty to act in the best interests of the company. The High Court held that Foo had breached that duty because there was no legitimate reason to pay himself in preference to the other creditors.

Foo appealed against the High Court's finding that he had breached the Creditor Duty.

Singapore Court of Appeal decision

The key issues before the Court of Appeal were as follows:

i. When, as a matter of law, is the Creditor Duty first engaged?
ii. Had the Creditor Duty in fact been engaged when Foo authorized the Impugned Transaction?

In addressing issue (i), the Court of Appeal also took the opportunity to reiterate and clarify the nature, scope and content of the Creditor Duty. These foundational points are set forth below.

1. The Creditor Duty is a fiduciary duty that directors owe to the company. This duty is not one that directors owe directly to creditors. The proper plaintiff is therefore the company, and the creditors cannot sue for breach.
2. Liquidation is not a condition precedent to the bringing of an action for breach of the Creditor Duty (*obiter dicta*).

3. It is not the case that the interests of creditors only become relevant when the Creditor Duty is engaged or that those interests are immaterial at other times. The predicate duty is a duty to act in the best interests of the company, and this requires directors to have regard to the interests of different stakeholders, including creditors, at all times.
4. Creditors ought to be understood as a class for the purpose of the Creditor Duty. Even as the respective positions of individual creditors may differ, it is sensible to consider the interests of creditors as a body where the Creditor Duty is at issue because the identities of the company's creditors constantly change so long as debts continue to be incurred and discharged by the company.
5. In an action for breach of the Creditor Duty, the relevant question is whether the director exercised his discretion in good faith in what they considered (and not what the court considers) to be in the best interests of the company, as understood with reference to the financial state of the company prevailing at the material time. Although the duty is a subjective one in that sense, the court will assess a director's claim objectively, by asking whether the view the director claims to have formed was one that is credible or was reasonably open to them, given the information available at the time.

6. The courts will take a practical and broad assessment of the financial health of the company to decide when the Creditor Duty should arise, and assess the company's solvency in a flexible manner, including a consideration of all claims, debts, liabilities and obligations of the company. The courts will not apply a strict and technical application of the "going concern" test or "balance sheet" test.
7. The Creditor Duty is just one of a panoply of duties that a director is subject to. For instance, a director is also subject to a duty to act with reasonable diligence in the discharge of their office. This encapsulates the director's common law duty to exercise due care, skill, and diligence.

As to *when* the Creditor Duty is engaged, the Court of Appeal **broadly endorsed** the decision of the UK Supreme Court in *BTI 2014 v Sequana SA and Ors* [2022] UKSC 25: Where the company is insolvent or bordering on insolvency but is not faced with inevitable insolvent liquidation or administration, the directors should consider the interests of creditors and balance them against the interests of shareholders where they may conflict. Once the liquidation or administration is inevitable however, the creditors' interests become paramount. Both courts also spoke in one voice as to the nature and doctrinal basis of the Creditor Duty.

The Singapore Court of Appeal went further and provided guidance as to the applicability of the Creditor Duty based on its financial state based on a three-category approach:

Category	Company's Financial State	Relevance and Applicability of the Creditor Duty
Category 1	A company is, all things considered (including the contemplated transaction), financially solvent and able to discharge its debts.	At this stage, the Creditor Duty does not arise as a discrete consideration. A director typically does not need to do anything more than acting in the best interests of the shareholders to comply with his fiduciary duty to act in the best interests of the company.
Category 2	A company is imminently likely to be unable to discharge its debts, including cases where a director ought reasonably to apprehend that the contemplated transaction is going to render it imminently likely that the company will not be able to discharge its debts.	In this intermediate zone, to determine whether the director has breached the Creditor Duty, the court will **scrutinise the subjective bona fides of the director**, with reference to the potential benefits and risks that the relevant transaction might bring to the company. The court will consider which factors **(including the recent financial performance of the company, industry prospects, and relevant geopolitical developments)** the director ought reasonably to have taken into account in assessing whether the contemplated transaction would result in imminent corporate insolvency. In category two situations, the Courts will allow directors to undertake actions to promote the continued viability of the company. While the director is not obliged to treat creditors' interests as the primary determining factor at this stage, the court will closely scrutinise transactions that appear to exclusively benefit shareholders or directors, such as the declaration and payment of dividends or the repayment of shareholders' loans.
Category 3	Corporate insolvency proceedings are inevitable	At this stage, there is a clear shift in the economic interests in the company from the shareholders to the creditors as the main economic stakeholders of the company, because the assets of the company at this stage would be insufficient to satisfy the claims of the creditors. The Creditor Duty operates during this interval to prohibit directors from authorising corporate transactions that have the exclusive effect of benefiting shareholders or themselves at the expense of the company's creditors, such as the payment of dividends.

On the basis of the above approach, the Court of Appeal reaffirmed the High Court's finding that the Creditor Duty was already engaged when the Impugned Payments were authorized by Foo. In reaching this conclusion, the following facts were considered:

i. OP3's financial statements reflected that the company was in poor financial health. The company had a negative net asset value of approximately half a million dollars immediately preceding and at the time at which the Impugned Payments were made (not factoring in its contingent liability in the lawsuit). Additionally, OP3 had also been experiencing a steep decline in business – its revenue had nosedived from S$10,834,505 in 2015 to S$1,343,323 at the end of 2016, and to S$316,888 by 31 December 2017; its profits were consequently impacted and plummeted from S$996,894 in 2015 to losses in 2016 and 2017.

ii. Foo argued that he believed OP3's contingent liability under the lawsuit would not arise as he sought legal advice from a law firm who advised that the company had a "strong defence". However, this argument was rejected by the Court of Appeal as the correspondence between Foo and the law firm was sparse; the mere fact that legal advice was taken does not inevitably mean that a defendant-director acted bona fide in taking a certain course of action. Foo also did not adduce cogent evidence to show that he honestly believed OP3 would face no liability. Thus, OP3 had contingent liability under the lawsuit that was reasonably likely to materialise. This had to be considered in assessing the solvency of the company when the Impugned Payments were made.

In light of the above, the Court of Appeal determined that Foo had breached the Creditor Duty by prioritising payments to himself over the claims of the other creditors.

In the circumstances, Foo failed to consider the interests of OP3's creditors and acted in breach of the Creditor Duty by authorizing the Impugned Payments to himself.

A point which carried significant weight was the nature of the payments that Foo approved. OP3's creditors gained nothing from these payments and the payments were not part of a strategic commercial decision to revitalise the fortunes of the company. Instead, the payments singularly enriched Foo at the expense of OP3's creditors. It was also emphasised that Foo did not draw any dividends in the years preceding the commencement of the lawsuit but paid himself S$2,800,000 in dividends and S$820,746 in loan repayments after the lawsuit was commenced against OP3.

Conclusion

The Court of Appeal's decision in *Foo v OP3* is of considerable assistance to directors and legal practitioners alike and will provide crucial guidance when directors of Singapore (and other Commonwealth) companies are contemplating a transaction in circumstances where the company's financial position is precarious. The decision is also good news for creditors and liquidators, in that it offers greater certainty in circumstances where claims against directors for a clear breach of duties may be the only route to recoveries for the insolvent estate.

Meiyen Tan is a director and Hannah Alysha is an associate director in our Singapore office and members of the firm's global restructuring group.

Liability-management transactions – While US bankruptcy courts send mixed messages to markets, lenders prepare for the next wave

James A. Copeland

Introduction

What's *en vogue* today might be *passé* tomorrow. Some trends are "out" before they're ever really "in," some stick around until a new one comes along, and others still come-and-go with the seasons. Liability-management transactions, or LMTs, might have seemed like another restructuring fad to some, but they're more popular than ever.

Why do LMTs seem to have such "staying power" across industries and sectors? For one thing, LMTs—or the risk of one—can provide cash-strapped companies with valuable leverage, particularly those with flexible credit documents (*e.g.*, covenant-lite and covenant-loose loans). Borrowers and their sponsors can use that leverage to partner with new and existing stakeholders to "redesign" capital structures, tapping new liquidity, refinancing legacy debt, and re-allocating value among stakeholders in the process. The flexibility of LMT-driven strategies is especially valuable in this economy, where domestic and global markets remain awash in uncertainty and upheaval. For lenders, LMTs are now an ever-present risk that could affect any number of credits throughout a portfolio.

In a previous article, we explored the emergence (or rather, re-emergence) of LMTs as a legitimate alternative for companies and their sponsors looking to address short-term liquidity challenges, lay the groundwork for a comprehensive restructuring, or accomplish other strategic objectives. We also provided an introduction to the most-common LMTs—"uptier" and "drop-down" transactions—and the typical LMT "playbook" to explain how these transactions exploit loopholes in credit documents to "unlock value" for some lenders at the expense of those that either declined—or weren't permitted—to participate. Since then, the appetite for LMTs has only grown, and with it, so have LMT-related lawsuits.

By choice or by circumstance, some borrowers land in chapter 11 after executing an LMT, often dragging with them a raft of complex litigation. In this article, we briefly review certain holdings in two recent decisions issued by Houston bankruptcy judges sitting in Houston, Texas in the US Bankruptcy Court for the Southern District of Texas regarding the *Robertshaw* and *Wesco Aircraft* "uptier" transactions and related disputes. We then examine two potential alternative LMTs certain borrowers might prefer to more-aggressive "uptier" and "drop-down" transactions that still dominate industry headlines. Lastly, we highlight key takeaways for market participants from the latest liability-management developments.

Litigation developments: *Robertshaw* and *Wesco Aircraft* provide some guidance, raise more questions

In the past couple of years, certain market participants have explored using the extraordinary relief available under the US Bankruptcy Code to short-circuit what would have otherwise been years of time-consuming, costly LMT litigation. chapter 11, in theory, provides borrowers and participating creditors an opportunity to quickly resolve their disputes with non-participating creditors and implement a comprehensive restructuring based on that resolution. As noted in our previous article, the *Serta Simmons* chapter 11 cases filed in the US Bankruptcy Court for the Southern District of Texas could have been viewed, at the time, as a template for resolving post-LMT disputes.

In *Serta*, after a prepetition uptier transaction and mixed litigation results, the borrower negotiated a restructuring support agreement and a chapter 11 plan before filing for bankruptcy relief, and immediately teed up its LMT-related disputes for rapid resolution by the bankruptcy court. Just two months after filing, the *Serta* court ruled in favor of the borrower and participating lenders, finding that the uptier

transaction “clearly” fell within the unambiguous terms of the “open market purchase” provisions in the credit agreement. The non-participating lenders then contested the confirmation of the borrower’s chapter 11 plan but lost again as the bankruptcy court found that all parties knew the borrower had built “flexibility” into the credit agreements and, as a result, non-participating lenders had to live with their bargain. The bankruptcy court’s *Serta* decisions are currently on appeal to the US Court of Appeals for the Fifth Circuit, which heard oral argument and took the appeals under advisement on July 10, 2024.

On the heels of the borrower’s and participating creditors’ triumph in *Serta*, two more post-LMT borrowers turned to the Houston bankruptcy court for relief. In June 2023, just days after Serta’s plan-confirmation trial concluded, Wesco Aircraft and its affiliates filed for chapter 11 relief and their cases were assigned to then Chief Judge David R. Jones, who also presided over Serta’s chapter 11 cases. Months later, in February 2024, Robertshaw and its affiliates filed for chapter 11 cases and their cases were assigned to Judge Christopher M. Lopez.

Wesco Aircraft and Robertshaw followed the *Serta* “playbook”: after executing prepetition uptier transactions, they sought to negotiate restructuring support agreements and related transactions with the participating creditors, later filed for bankruptcy relief, and ultimately made the timely resolution of uptier-related litigation the “centerpiece” of their chapter 11 cases. Both cases appeared to be headed down the path *Serta* had just cleared, but so far, only the Robertshaw debtors made it to the end.

***Robertshaw* court finds that minority creditors must live with their bargain.** Robertshaw, an engineering and manufacturing firm, was acquired by an its sponsor company in 2018. At some point, Robertshaw’s lender group organized into two factions: an ad hoc group of lenders and an individual lender. In 2023, Robertshaw and certain of its lenders executed multiple related transactions that set the stage for a contentious chapter 11 case.

First, in May 2023, Robertshaw negotiated an uptier transaction with *both* factions (*i.e.*, the ad hoc group and the individual lender) that included a new-money first-lien financing and the exchange of participating lenders’ existing holdings for higher-priority debt, and also conferred on the participating lenders, as a combined voting bloc, “required-lender status” under the new credit agreement.

Sometime in July 2023, however, the individual lender increased its holdings and became the sole "required lender" without the ad hoc group's knowledge. Then, in the fall of 2023, Robertshaw faced another liquidity crunch and attempted to negotiate a refinancing transaction with a third party. The individual lender did not support the third-party transaction and, over a number of weeks, entered into various credit-agreement amendments typical in a potential workout scenario (*e.g.*, certain waivers and forbearances, key financial accommodations, bankruptcy-filing milestones, and the like). The ad hoc group learned about the amendments only later from another source, and then began negotiating an alternative transaction with Robertshaw and its sponsor.

Ultimately, Robertshaw's board approved the ad hoc group's alternative transaction. In December 2023, Robertshaw and the ad hoc group implemented a multi-step proposal, which included financing a debt repayment that allowed the ad hoc group to become the "required lenders" under the existing credit agreements, further authorized Robertshaw to issue new first-out and second-out loans, and simultaneously eliminated the individual lender's status as "required lender under the same credit agreements." The individual lender then sued in New York state court to nullify the transactions and regain control under the credit agreements, but those disputes were ultimately argued before the Houston bankruptcy court after Robertshaw's chapter 11 filing.

In June 2024, the bankruptcy court denied the individual lender's request to unwind the transaction, and largely ruled in favor of Robertshaw, its sponsor, and the ad hoc group. The rulings were firmly rooted in the interpretation of the first-lien credit agreement. With respect to breach-of-contract claims, the bankruptcy court found that the only breach committed by Robertshaw was its failure to comply with mandatory-prepayment provisions. The bankruptcy court further found that, under the "four corners" of the agreement, the individual lender's sole remedy was a claim for monetary damages. Thus, the bankruptcy court expressly declined to use its equitable powers to unwind the transaction and re-allocate control among the lenders. With respect to other equitable and tort claims, the bankruptcy court observed that the May 2023 uptier-exchange transaction "established a baseline of conduct" among the lenders, and that the individual lender then "engaged in acts it now calls bad faith." Consequently, neither Robertshaw nor the ad hoc group breached the "implied covenant of good faith and fair dealing" under New York law, and Robertshaw's sponsor did not tortiously procure any breach of the credit agreements.

***Wesco Aircraft* court partially invalidates prepetition uptier-exchange.** Like the *Robertshaw* borrower, Wesco Aircraft Holdings, a supply-chain management-services provider, operating as "Incora," was the product of a leveraged buyout financed through secured notes maturing in 2024 and 2026, and unsecured notes maturing in 2027.

In March 2022, Wesco and certain participating lenders executed an uptier-exchange transaction. Before the transaction, the participating lenders held a supermajority voting position (*i.e.*, two-thirds of the outstanding notes) under the 2024 indenture, but only a simple majority under the 2026 indenture. The default rule under both indentures was that indenture amendments were prohibited unless a supermajority of noteholders consented. Wesco and the participating lenders sought to circumvent the supermajority-consent requirement by implementing the transaction through two indenture amendments.

The first amendment was structured under an exception to the above "default rule" that permitted Wesco to issue the "additional notes" with only a simple majority of consenting noteholders. Relying on this exception, the participating lenders consented to an indenture amendment that allowed Wesco to issue "additional notes" under the 2026 indenture, the participating lenders then purchased the newly issued "additional" 2026 secured notes and, as a result, gained a supermajority position under *both* the 2024 and 2026 indentures. The participating lenders then used their newly acquired voting power to approve the second indenture amendment, which authorized the exchange of their existing 2024/2026 notes for new 2026 secured notes and stripped non-participating 2024/2026 noteholders' liens.

Like the individual lender in *Robertshaw*, the non-participating noteholders sued in New York state court to, among other things, unwind the transactions, but those disputes were later removed and brought before Judge David R. Jones in the Houston bankruptcy court (who presided over the *Serta* chapter 11 cases). At that point, *Wesco Aircraft* seemed on its way to being the next *Serta*. But in October 2023, with summary-judgment motions pending, Judge Jones resigned from the bench and *Wesco Aircraft* was re-assigned to Judge Marvin Isgur. Judge Isgur then ruled that a number of claims and disputes survived summary judgement, and the parties proceeded to a 30-day trial on the remaining issues.

On July 10, 2024, the *Wesco Aircraft* court issued an oral ruling that partially invalidated the uptier-exchange transaction. The court viewed the transaction as "dominos": after the first

amendment was executed, the result (*i.e.*, stripping non-participating 2026 noteholders' liens) was "inevitable." Thus, the court found that the first amendment "had the effect" of releasing the non-participating 2026 noteholders' liens and, as a result, the amendment could not have been executed without supermajority consent under the then-existing indenture's terms. The participating creditors were only able to reach the supermajority-voting threshold through the subsequent issuance of the additional 2026 secured notes. Unlike the outcome in *Robertshaw*, the bankruptcy court determined that, under the circumstances, the transaction, at least in part, had to be unwound.

The ruling restored all of the 2026 secured noteholders' rights and liens as if the uptier-exchange never occurred, whereas the 2024 noteholders' liens were not restored because the court found that the requisite two-thirds majority of 2024 noteholders consented to the lien-stripping amendments in the uptier-exchange. Finally, the *Wesco Aircraft* court indicated that its oral ruling would later be replaced and superseded by a full written opinion (which had not been issued before this article was published).

Lessons learned? In liability management, where every transaction is tailored to the facts and circumstances, every LMT stands alone. The same is true for the LMTs at issue in *Robertshaw* and *Wesco Aircraft*. Still, these cases reflect certain common themes and issues (*e.g.*, shifting or "manipulation" of lender voting power, transaction sequencing) that are often implicated in some way in most LMTs and related litigation. For that reason, both commentators and litigants have argued that *Robertshaw* and *Wesco Aircraft* are contradictory decisions, leaving the market without clear guidance. There is, at minimum, "tension" in aspects of the analysis and divergence in the results.

Both cases included facts that, arguably, involved some degree of "voting manipulation," as rival lender groups vied for supermajority or "required lender" control under credit documents, and both cases involved requests by non-participating or excluded lenders to avoid or unwind the resulting transactions. In *Robertshaw*, "vote rigging" allegations didn't factor into the analysis, but similar allegations in *Wesco Aircraft* were "front and center." In *Robertshaw*, the court's remedy selection was defined by the credit agreement's negotiated terms rather than a broad equitable inquiry, but in *Wesco Aircraft* the court felt compelled to undo portions of the transaction, clearly troubled by the notion that management and their supporters could take "someone's property rights" away while purportedly acting in the borrower's best interest. These holdings are difficult to reconcile, but provide some high-level guidance: "words still matter," precise drafting should remain front of mind, but one should pause before elevating "form over substance," and bankruptcy courts will take care to ensure that stakeholders cannot "structure away" good faith and fair play.

While early signs indicate that the market may be moving toward less-aggressive transactions, it's too soon to tell how far it will move and what's motivating that movement. It may be wise to reserve judgment until the full written *Wesco Aircraft* opinion is issued. For now, it is clear that the *Robertshaw* and *Wesco Aircraft* cases, as well as the *Serta* appeals and developments in the Houston bankruptcy court, need to be closely watched by players and professionals in the LMT market for the foreseeable future.

Market outlook: Recent litigation results might influence pending and future transactions

"Uptier" and "drop-down" transactions still dominate the LMT landscape because of their demonstrated ability to bolster participating creditors' recoveries and deliver at least some balance-sheet relief to distressed borrowers. These transactions will likely remain the market's "go to" LMTs in the near future. After accounting for litigation risk and differing decisions like those in the *Serta*, *Robertshaw*, and *Wesco Aircraft* chapter 11 cases, some borrowers and lenders may choose another path. For some, particularly those exploring less-aggressive options, that path could lead them to consider another increasingly popular type of LMT: the "double dip." Like other LMTs, the term "double dip" encompasses an array of transactions; however, double dips generally come in two flavors: either a basic double-dip, or a "pari-plus" double-dip transaction.

Double-dip structures, both of the basic (*e.g.*, *At Home* and *Wheel Pros*) and pari-plus (*e.g.*, *Sabre*, *Trinseo*, and *Rayonier*) variety, have become popular alternatives in the last year or so. A key difference between the double-dip structure and other LMTs is that, in a double dip, new-money creditors attempt to maximize their recoveries by creating "new claims" throughout the borrower's corporate family and capital structure.

Basic and "pari-plus" double-dip transactions. A "double dip" is a multi-part, but still straightforward, set of financing transactions. At a high level, double dips are implemented in two phases:

- First, one of the borrower's subsidiaries, a "financing sub," will incur a new-money secured loan. That new-money loan will typically be guaranteed and secured by entities and assets already *within* the borrower's existing credit group (*i.e.*, the guarantors and collateral that support the borrower's existing debt).
- Second, the financing sub then on-lends the proceeds of the new secured facility to the borrower through an intercompany loan and, in turn, pledges that intercompany loan to the double-dip lender. In this case, the "first dip" is the double-dip lender's claim against *existing* guarantors or collateral, and the "second dip" is the pledged intercompany claim against the borrower.

A basic double dip gives a new-money lender multiple direct and indirect claims at strategic points in the borrower's existing credit group. In theory, long-standing bankruptcy principles and caselaw would allow the double-dip lender to pursue US$2.00 in claims against different credit-group entities for every US$1.00 advanced to the financing sub through the new-money loan.

A "pari-plus" transaction is a subset of the double-dip genre. In a pari-plus transaction, the "first dip" in the basic double-dip structure is enhanced by having entities that are *outside* the existing credit group incur or guarantee the new-money secured facility. Consequently, the double-dip lender in this transaction is "pari" in respect of the intercompany claims provided through the "second dip" above, "plus" benefits from structurally senior claims on any assets of the obligors that are outside of the borrower's existing credit group.

More double-dip transactions on the way? Double-dip structures seem poised for another big year. Like other LMTs, double-dip proceeds can be used to plug liquidity holes, refinance legacy debt, or fund strategic initiatives in a challenging operational and financial environment. Moreover, a double-dip facility can be implemented as a standalone LMT or in conjunction with another LMT (*e.g.*, an uptier, drop-down, or other combination of transactions) to provide participating lenders with additional credit support.

These LMTs may also prove more attractive to some borrowers and creditors looking for a "cleaner" or facially "less aggressive" structure in the wake of *Wesco Aircraft* (not to mention lingering uncertainty regarding the fate of *Serta*'s bankruptcy strategy at the Fifth Circuit). The "mere dilution" of existing lenders' claims in a double dip may seem less "violent" than the lien-stripping, asset-shuffling, "overnight" subordination, and disenfranchisement that characterize other LMTs. In addition, double-dip transactions (in most cases) rely entirely on exploiting covenant capacity and basket availability in the borrower's *existing* credit documents (*e.g.*, a borrower must have sufficient debt-and-lien-covenant capacity for the financing sub to incur the new-money secured facility), which allow borrowers to negotiate and implement double-dip transactions on a tight timeline and with minimal process or interference from non-participating or excluded lenders.

Still, this strategy is not without risk. Although challenges to uptiers and drop-downs in bankruptcy have led to mixed results, double-dip financings have not been tested in bankruptcy court. Double-dip transactions rely on the creation of a collection of direct and indirect claims to bolster lender recoveries; if any one claim, or class of them, were to fall away through the chapter 11 process, a double-dip lender's exposure could dramatically change.

Takeaways

Under current market conditions, LMTs aren't going away. They are, at least for now, a fact of life and lenders will need to fully assess and track LMT-related risks and developments throughout their portfolios. Results like *Robertshaw* and *Wesco Aircraft* in many ways seem to reinforce the need for lenders to negotiate unambiguous credit documents that incorporate the latest protective "technology" whenever possible. But in the absence of clearer signals from federal and state courts, lenders should prepare for a new wave of "creativity" in the LMT space, including comparatively novel structures (*e.g.*, double dips), and bolster their "early-warning systems" to ensure that they aren't caught flat-footed when distressed borrowers start looking to other sources for financial solutions.

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McDermott's parallel restructuring proceedings: UK restructuring plan meets the Dutch WHOA

Prof. Omar Salah, James Stonebridge, Bas van Hooijdonk and Jan de Wit

In March 2024, McDermott successfully completed a first-ever restructuring implemented by combining the UK Restructuring Plan under Part 26A of the Companies Act 2006 (CA) and the Dutch WHOA (the acronym for the *Wet Homologatie Onderhands Akkoord*). The McDermott restructuring builds upon the previously successful use of parallel restructuring proceedings in the Netherlands and the UK: the restructuring of the Vroon group where the Dutch WHOA was used in parallel with the UK Scheme of Arrangement, which we covered in the Q4 2023 Newswire at Vroon restructuring: A lesson in adapting to and overcoming challenges.[1]

In this article, we discuss the key issues in McDermott, which could be relevant for future restructurings involving parallel proceedings.

Background

McDermott is a Houston, US based contracting and energy sector engineering conglomerate with operations in more than 54 countries. As a result of financial setbacks, McDermott filed a chapter 11 case in the US in 2020. This restructuring did not prove to be a long-term solution and the McDermott group entered into another round of restructuring negotiations with its creditors in 2023.

The McDermott group has several group companies in various jurisdictions, including the Netherlands and the UK. Lealand Finance Company B.V. (**Lealand**), a legal entity incorporated in the Netherlands, acted as a financing vehicle and is a wholly owned subsidiary of Dutch holding company McDermott International Holdings B.V. (**MIH**). Several entities within the McDermott Group, including MIH and UK based CB&I UK Limited (**CB&I**), issued guarantees in respect of Lealand's obligations.

McDermott faced looming and significant liquidity issues in 2024. Certain letter of credit facilities were required to be cash collateralised by 24 March 2024 and certain term loan facilities were to mature on 30 June 2024. Whilst the maturity dates were known upfront, an arbitration award in July 2023 formed the trigger for financial distress. CB&I and MIH were found liable to Refinería de Cartagena S.A.S. (**Reficar**) for an amount of approximately US$1.3 billion as a result of an arbitral award that was issued in 2023 after seven years of arbitration.

The impending requirement to provide cash collateral and the term loan maturity date prompted McDermott to enter into negotiations with its lenders in 2023 regarding a financial restructuring. McDermott reached an agreement with its lenders whereby the maturity date of the letter of credit facilities and the term loan facilities would be extended to 2027. The extension of the maturity date of the letter of credit facilities meant that they did not need to be cash collateralised until 2027. McDermott and its lenders then filed parallel Dutch WHOA and UK Restructuring Plans to implement the restructuring and cram down Reficar.

This resulted in a vociferous objection from Reficar. Following difficult and prolonged negotiations and restructuring litigation, McDermott managed to reach a settlement with Reficar in the proceedings under which Reficar obtained significant equity in exchange for the claims reflected in arbitral award. In the process, the UK and Dutch courts were required to address several key issues.

1 Norton Rose Fulbright has been advising on both parallel restructuring proceedings. We acted as counsel to the secured creditors committee in the restructuring of Vroon, including the Dutch WHOA proceeding and the UK Scheme of Arrangement. We acted as counsel to a lender in the restructuring of McDermott in the parallel Dutch WHOA and UK Restructuring Plan in 2023 and in the earlier restructuring through the US chapter 11 case in 2020.

WHOA proceeding

Under the Dutch Bankruptcy Act, a debtor may offer its creditors and shareholders a restructuring plan to amend their rights when the debtor finds itself in the vicinity of insolvency. Such plan may be offered through a private or a public procedure. Dutch courts have jurisdiction in private procedures if there is sufficient connection with the Netherlands (e.g., if the debtor has assets in the Netherlands). The public procedure is listed on Annex A of the EU Insolvency Regulation (Recast) (**EIR**).[2] Dutch courts have jurisdiction to open a 'main insolvency proceeding' under the EIR only if the debtor has its centre of main interest (**COMI**) in the Netherlands.

COMI – The Netherlands or elsewhere?

MIH commenced a public WHOA procedure and, therefore, was required to have its COMI in the Netherlands. Article 3(1) of the EIR states that the jurisdiction in which the debtor has its registered office is presumed to be the place of its COMI in the absence of proof to the contrary. MIH has its registered office in the Netherlands, therefore the opponents of the restructuring plan had to prove that the COMI of MIH was actually located elsewhere. Pursuant to the EIR, the presumption that the COMI of an entity is located in the jurisdiction of its registered office may be rebutted with objective indications, which are verifiable for third parties, that show that the COMI is located elsewhere. In a WHOA procedure, international jurisdiction is determined during the first hearing by the court. At that hearing, Reficar argued that MIH's COMI was not located in the Netherlands by stating that: (i) MIH and the McDermott group present itself to the outside world as a consolidated, Houston, US, based group, (ii) MIH's lacked nexus with the Netherlands and it provided insignificant management services, and (iii) MIH never presented itself as having nexus with the Netherlands in the arbitral proceeding against Reficar. The Amsterdam District Court rejected Reficar's arguments and, *inter alia*, ruled that (i) MIH and MIH's subsidiaries employ a large number of employees in the Netherlands, (ii) MIH has large headquarters in the Netherlands from which it manages Dutch and foreign subsidiaries, and (iii) MIH is addressed in the Netherlands in several instances, even by Reficar. Hence, the Amsterdam District Court ruled that the presumption that MIH's COMI was located in the Netherlands had not been rebutted by Reficar.

Reficar appealed the judgment regarding MIH's COMI. The appeal was based on the right that article 5(1) EIR provides to *all* creditors (and debtors) to challenge a decision to open main insolvency proceedings on grounds of international jurisdiction. Under Dutch law, such right to challenge is only available to creditors and debtors if such party has *not* been provided the opportunity to present their views regarding international jurisdiction. In the Netherlands, the EIR has immediate legal effect over and above Dutch national law. Reficar argued that it was unlawful that Dutch law provides tighter margins for challenging a court's decision than the EIR does by only allowing certain parties rather than all creditors and debtors the right to appeal. An appeal is not possible under the WHOA and the Amsterdam Court of Appeal noted that Reficar failed to provide reasons to overturn this principle. The Amsterdam Court of Appeal further ruled that the rationale behind article 5(1) EIR is to provide creditors and debtors with an 'effective remedy' against a decision by a national court regarding international jurisdiction. According to the Amsterdam Court of Appeal, Reficar was provided such effective remedy, as it had (and utilised) the ability to present its arguments against the international jurisdiction of the Dutch courts before the Amsterdam District Court.

Restructuring expert vs. observer

Both Reficar and a dissenting group of lenders under the letter of credit facilities (the **LC Group**) petitioned the court to appoint a restructuring expert, while McDermott petitioned the court to appoint an observer. Under Dutch law a restructuring expert plays an important role in the restructuring process. The restructuring expert is responsible for the preparation of the WHOA restructuring plan. The restructuring expert is required to act in the interests of the joint creditors and conduct tasks neutrally and independently. An observer, however, has a more passive role and will observe the restructuring process, whilst taking into account the interests of the creditors.

Given their role and tasks, a restructuring expert will require some time to get fully up to speed in a restructuring process that is nearing completion, as was (at least initially) the case in the McDermott restructuring. Dutch courts are reluctant to appoint a restructuring expert in such instances, given that an appointment might delay the process and the threat of delay can be used strategically by opposing creditors as leverage. Delays are less of an issue in considerations to appoint an observer due to the observer's more passive and, hence, less disruptive role.

2 Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast).

In the McDermott case, the court recognized that the restructuring was nearing completion but appointed a restructuring expert nonetheless to safeguard the interest of the creditors. The court did so because (i) it had serious doubts regarding the independence of the McDermott board of directors (noting that lenders had taken control over McDermott as part of the previous chapter 11 restructuring and the debtors and lenders were more interconnected than is usually the case); (ii) it had doubts whether the draft restructuring plan would adhere to the 'absolute priority rule', rules for class composition and rules for new financing under the WHOA; and (iii) the valuation reports raised potential concerns. According to the court, the involvement of an independent party (rather than the board whose independence was at stake) would increase the parties' confidence in the process and thereby the chances of success. As a result, the court appointed a restructuring expert who eventually amended and filed the final WHOA restructuring plans with the Amsterdam District Court.

Was McDermott nearing insolvency?

Under Dutch law, a debtor commencing a WHOA must be in the vicinity of insolvency, i.e. the debtor must show that it is reasonably likely that it will not be able to pay its debts in the foreseeable future (e.g. Dutch courts generally look one year ahead) (the **Pre-Insolvency State**).

Reficar argued that McDermott was not in the Pre-Insolvency State because, along with the other creditors, Reficar intended to reach a resolution of the financial issues without the McDermott group tumbling into a free-fall insolvency process. Reficar further argued that the letter of credit issuers would never take enforcement measure against McDermott. These parties had issued these letters to McDermott's project counterparties to cover, *inter alia*, project delays. According to Reficar, enforcement measures by the letter of credit issuers would lead to project delays and in turn to mass demands by the project counterparties under the letters of credit, which would lead to actual and (partially) unrecoverable exposure for the letter of credit issuers. It was, therefore, deemed highly unlikely by Reficar that such issuers would actually take enforcement measures if McDermott failed to provide cash collateral by 24 March 2024. Reficar also indicated that the cash-flow analysis provided by McDermott was lacking and that it did not substantiate McDermott being in the Pre-Insolvency State.

The court rejected Reficar's arguments and noted that the letter of credit banks alleged reluctance to enforce security – even if true – did not mean that McDermott would be able to pay the debt (i.e. the key focus of the Pre-Insolvency State). Similarly, the court considered that Reficar's intent to reach a solution was not evidence that McDermott was able to pay the US$1.3 billion debt owed to Reficar, which again is the key point.

UK Restructuring Plan

Under Part 26A CA a distressed company may offer its creditors a restructuring plan, whereby dissenting creditors can be crammed down upon judicial sanctioning. CB&I offered such plan, which Reficar opposed until a settlement was reached. In its judgment, the English court reflected on Reficar's arguments against its possible cram-down, before sanctioning CB&I's restructuring plan under Part 26A CA.

Compromise or arrangement?

A restructuring plan can only be proposed if that plan qualifies as a compromise or arrangement. This requires an element of "give and take", as per LJ Snowden's judgment in *NFU Development Trust Limited* in 1972. Reficar argued that its claims were simply extinguished under the proposed plan and, therefore, the plan could not qualify as a compromise or arrangement.

At the outset of McDermott's restructuring very marginal consideration was offered to Reficar for the extinguishment of its approximately US$1.3 billion claim. The consideration offered was a participation instrument through which Reficar could recover a maximum of 0.2% of its claim. As the negotiations progressed, Reficar's proposed consideration increased significantly, ending with Reficar being offered an equity instrument valued at approximately US$900 million, which was also offered under the restructuring plan presented to the English court. The amount of this consideration rendered it impossible for Reficar to argue that its claim was extinguished for no consideration and that no compromise or arrangement was presented. Notwithstanding the significant amount of consideration, the English court took the liberty to reflect on the contours of the "compromise or arrangement" requirement. LJ Green maintained that, as per established case law, even an out-of-the-money creditor is entitled to some form of compensation for the extinguishment of its claim as part of the "give and take". Such compensation, however,

may be a very small fraction of the creditor's affected claim. In this case, the threshold was met, even if Reficar was allocated the original participation instrument through which Reficar could recover a maximum of 0.2% of its claim.

What is the relevant alternative?

Unlike the class of secured creditors, Reficar voted against the restructuring plan that was presented to the court. As the secured creditors voted in favour, LJ Green had to consider whether a cross-class cram down of Reficar was allowed under Part 26A CA. Part 26A CA allows for this if certain conditions are met. One of which is that Reficar cannot be worse off under the proposed plan compared to the relevant alternative. The relevant alternative was the heavily debated core issue during the trial. As per Part 26A CA, the relevant alternative is whatever the court considers to be the most likely to occur to the distressed company if the plan is not sanctioned. As per established case law, this does not imply that, for a scenario to qualify as 'relevant alternative', it has to be proven that a scenario would definitely or, paradoxically, even *likely* develop (*Virgin Active*) if the plan is not sanctioned. A party has to prove that the proposed alternative is more realistic than the other and sometimes multiple scenarios presented to the court. Hence, the relevant alternative is determined pursuant to a relative criterion, rather than an absolute criterion, whereby the other scenarios brought forward serve as competitors.

McDermott presented a relevant alternative in which McDermott's value breaks in the secured debt, where Reficar, as unsecured creditor, would undoubtedly be worse off than under the proposed plan. This scenario assumed a collapse into a form of insolvency, whereby most parts of McDermott were to be sold piece-meal. Reficar argued that the relevant alternative to the proposed plan was more value preserving, as Reficar wanted to raise the aforementioned 'no-worse-off' threshold. The scenario it presented was that upon failure of the proposed plan, a re-launch of the negotiations between Reficar, McDermott and its key stakeholders would take place resulting in a deal between the parties and a fairer distribution of the restructuring surplus.

The English court dismissed Reficar's scenario as a likely alternative by noting that Reficar's behaviour rendered their scenario unrealistic. Reficar, as unsecured creditor, did not accept an offer including equity valuing at roughly US$900 million as consideration for the extinguishment of its approximately US$1.3 billion claim. Moreover, Reficar retained the right to draw under a US$95 million letter of credit after the plan was sanctioned and would be transferred insurance coverage with a remaining cover limit of US$213 million. LJ Green deemed this offer "very generous" and noted that it had the explicit support of the Dutch restructuring expert. According to LJ Green, the non-acceptance of this generous offer rendered Reficar's relevant alternative – a deal whereby the insolvency of McDermott was avoided – highly unlikely.

LJ Green finally concluded that a formal liquidation was the most likely alternative scenario and, therefore, was the relevant alternative to the sanctioning of the plan. Thus, Reficar's position on insolvency was to be benchmarked against Reficar's position under the proposed plan. As mentioned, Reficar would be out-of-the-money in the former scenario, so it was better off under the latter in which it would be distributed value.

Unfairness to an out of the money creditor

Even if all conditions for sanctioning of a restructuring plan under Part 26A CA are met, the court has discretion on whether or not to sanction the plan. One of the factors that may direct its discretion—is the fairness of the plan.

Reficar argued that the proposed plan could not be considered fair, as the equity of the McDermott group was largely held by certain of the secured creditors, whose equity position remain unaffected. LJ Green paraphrased Reficar's position as the equity sharing in the restructuring surplus, while the unsecured creditor's claims were released for next to nothing. Considering these words, LJ Green seemed to have considerable sympathy for Reficar's argument. He also noted, however, that from *Virgin Active* it follows that such treatment of out-of-the-money creditors is allowed. LJ Green concluded the matter with the rather nuanced remark that, notwithstanding the foregoing, he could see the force in Reficar's argument that in testing the fairness of the plan, there should be some scope for comparison of the distribution of the restructuring surplus under the plan between out-of-the-money creditors and shareholders.

The abovementioned arguments regarding fairness of the distribution, eventually, were only interesting in the context of points that may be raised in future cases. The sanctioned plan did not contain the release of Reficar's claims for next to nothing, but rather provided them with equity instruments with very significant value, thereby also impairing the equity holders. LJ Green concluded that Reficar had clearly secured for itself a fair distribution.

Conclusion

McDermott's 2024 restructuring procedure proved to be a landmark case from both a Dutch and an English perspective, with important lessons learned regarding these restructuring procedures. The Dutch courts rendered important decisions regarding the Pre-Insolvency State and the possibility to appeal a COMI decision in the light of the EIR. Further, the Dutch courts stressed the importance of introducing an independent party in a WHOA restructuring process by appointing the restructuring expert. Interestingly, the English court explicitly utilised the restructuring expert's opinion in considering the relevant alternative, thereby leveraging the dual nature of the parallel restructuring proceedings. From an English perspective, LJ Green provided a valuable nuance regarding the fairness of the distribution of the restructuring surplus to out-of-the-money creditors, which might mark a first step towards re-considering the rights of out-of-the-money creditors in an English Restructuring Plan. LJ Green further confirmed the *status quo* of perspectives on what constitutes a 'compromise or arrangement' under the Companies Act 2006 and what determines the relevant alternative as a no-worse-off benchmark.

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Private credit: An emerging market

Scott Atkins, Sarah Oh

Private credit market

The private credit market has significantly expanded and continues to grow. In early 2024, the private credit market topped US$1.5 trillion and is expected to double in size to US$2.8 trillion by 2028 globally. Private credit today has record investments, with leading investment firms like Blackstone recording over US$200 billion and Apollo over US$268 billion.[1] Debt from private credit funds has become not just a supplement but a substitute to syndicate loans, bank loans and bonds.[2] Coined as a 'golden age' for the private credit market, various capital market trends have facilitated the growth of private credit.

Factors for the rise

Factors for the expansion of private credit markets include stricter lending requirements by banks, which have reduced lending to only specific types of assets, forcing companies to seek out funding sources elsewhere. Moreover, private credit funds tend to be a more favourable alternative for larger corporate borrowers as private credit requires less disclosures, costs and regulations.

Country-specific market trends also matter. For instance, reliance on private credit for risk management and capital allocation have become more attractive for Australia as its bond market is not as substantial as other countries, leading to a nearly AU$200 billion Australian private credit market. Furthermore, there has been a growing interest of borrowers and sponsors for more flexibility and long-term relationships, which private credit provides for.

Another market factor is how debt and equity are increasingly becoming interlinked. New research examines how private credit exemplifies how debt and equity have closely related characteristics. Viewed in the corporate governance lens, private credit lenders often seek for certain control rights (i.e. board representation on borrower's board, participation in growth of firm) and returns that parallel equity holders.[3] Specifically, with the lack of liquid secondary market for private credit and lenders in private credit holding loans until maturity, the loan agreements usually include an equity component or a management role in the company.

Moreover, shareholders' interest and debt holders' interest also overlap when the private credit fund and the sponsor (private equity) are related or affiliated.[4] With investors often seeking for profit maximisation and capital growth in the long term, investors are now focusing on private credit for less volatility.

Opportunities

Renewable energy

A key area wherein private credit is likely to dominate is in the renewable energy sector as it is in need of investments from markets. With banks hesitant on fossil fuel transactions due to climate risks and uncertainty, borrowers are turning to private credit for capital. One of the world's largest private credit fund, Blackstone has recorded the largest funding of US$7 billion for the renewable energy and infrastructure space, particularly in relation to solar, hydro, and additional infrastructure for the energy transition. Blackstone further expects a US$100 billion opportunity in energy transition in the next decade.

Jurisdiction

The Asia-Pacific (APAC) region is having an expanding demand size for private credit. While private credit has traditionally been geared towards the US and European markets, there is growing interest in APAC for diversification purposes. For instance, private credit funds that target Asia have increased by 76% to US$11.2 billion. Although banks still hold a dominant 79% of total credit in the APAC region

1 Jared Ellias Presentation at the Singapore Global Restructuring Initiative (SGRI) (2024).
2 Jared Ellias and Elisabeth de Fontenay, 'The Credit Markets Go Dark' 134 Yale Law Journal (2024) Forthcoming.
3 Narine Lalafaryan (2024) 'How Debt Investors are Influencing Corporate Governance' Columbia Law School Blue Sky Blog published May 30, 2024.
4 Narine Lalafaryan, 'Private credit: a Renaissance in Corporate Finance' (2024) Journal of Corporate Law Studies vol 24 issue 1.

compared to the 33% in the US, some speculate that APAC is showing trends reminiscent of the period prior to the boom in private credit in the West. However, with geopolitical issues and the governments' priority in bank lending in Asia, investors are knocking on Australian markets as the focal point of APAC.

Australia's commercial real estate and asset-based finance

Private credit is having an expanding role in Australia's commercial real estate. The trend is driven by the slow lending of banks to the property sector in a time where the commercial real estate sector requires capital. Banks have shown growing reluctance in lending to high-risk areas of construction, especially with how construction companies have hit a record number of insolvency cases the previous financial year. According to Australian Securities and Investments Commission (ASIC), Australia's corporate watchdog, there has been an 28% increase in insolvency over the year with already 2,832 construction industry insolvency appointments in the 2024 financial year ending June. With the increased vulnerability of the commercial real estate sector, reliance on private credit funds is on the rise.

The growth of private credit in this sector has broader implications. Asset-backed finance, which makes up a more than US$20 trillion market and is larger than the corporate credit market, is predicted to be a key area for private credit. While private credit has been focused on corporate credit, asset-backed finance is likely to be the new class of asset for private credit.

Implications

Barriers

While these opportunities exist, there are some challenges that arise from the expansion of the private credit market. As there is no market price to be valued from, some commentators speculate that there could be unintended consequences of mistaken valuations by private companies and increased incidences of fraud.[5] The transparency is further obscured when considering the lack of disclosure requirements. When the debt market shifted to syndicated loans, more information of companies, particularly of private companies, was available to the public. However, with the reliance on private credit, corporate debt information has been secluded and less publicly available. The decline of

5 Jared Ellias and Elisabeth de Fontenay, 'The Credit Markets Go Dark' 134 Yale Law Journal (2024) Forthcoming.

available information limits details on the company's assets, governance, capital structure, and relevant equity and debt values. Consequently, there may be a lack of accountability and transparency with the limited disclosure requirements.

The issue is compounded by how private credit funds have minimal regulations in Australia, with disclosure only required if sold to sophisticated investors. Recent investigation by *The Australian Financial Review* has also demonstrated that there is reluctance in writing off and notifying on poor performance loans. Moreover, there are also growing situations where funds are given to companies that subsequently default. With the disclosure standards in Australia falling short of the US, ASIC has recently stated that it will take steps to scrutinise against private credit funds. It has recently announced that a taskforce has been set up to determine the state of the private credit market. Whether further regulatory steps or consequences will emerge is still yet to be seen.

Connection with insolvency

Private credit has become a useful tool in periods of distress particularly because private credit lending focuses on financial sponsors who tend to extend the period for default. In fact, during COVID-19 distress periods, private credit had a lower default rate than other leverages. The low default rate can be attributed to the strong relationship between borrower-lender in private credit market which allows the parties to actively tackle any emerging default signs. A recent study by S&P 500 found that payment defaults in private credit remained low during 2020 to mid-2024. With increased reliance on private credit, however, comes risk. Private credit increases leverage and make business more susceptible to financial risks, especially in a market of rising interest rates.

Other impacts on insolvency could be an increase in the so-called 'zombie firms' wherein companies do not take actions to reduce debt despite the extensive debt they have.[6] Experts point out how private credit lenders tend to postpone when they take the losses to avoid damage to their portfolio. Consequently, zombie companies are likely to encounter bankruptcy at later stages of their financial distress, which can subsequently lead to liquidations. With such shift, it will be vital to consider the private credit fund stakeholders in insolvency matters.

Key takeaways

Private credit is becoming a dominant investment class with potential for high returns. In more commercially risky and rising areas of renewable energy and commercial real estate, private credit has been a key asset. The risk of this surge in private credit is the lack of regulation and oversight. However, with movements by regulators, it is likely that there will be growing scrutiny over the private credit market. With the limited information and disclosure on private credit, further findings of its expansion, trends and barriers will be critical to determine how this booming area is shaping the broader commercial landscape on a global level.

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6 Jared Ellias and Elisabeth de Fontenay, 'The Credit Markets Go Dark' 134 Yale Law Journal (2024) Forthcoming.

Misfeasant trading: how will the court calculate compensation?

Re BHS Group Ltd & others [2024] EWHC 2166 (Ch)

Nicole McKenzie, Helen Coverdale, James Stonebridge, Mark Craggs

Overview

In the previous edition of Newswire, we reported on the first successful case of misfeasant trading in the United Kingdom (UK) and arguably the most important decision on directors' duties in the zone of insolvency since the UK Supreme Court's landmark decision in *Sequana*[1]. The claim had been brought by the liquidators of several companies in the well-known retail chain, British Home Stores group (BHS). In those proceedings, two directors were ordered to make payments exceeding £18 million in connection with BHS' trading prior to the commencement of insolvency proceedings (the June 2024 Judgment), although the court deferred ruling on the total amount payable in respect of the misfeasant trading claim. In a new Judgment[2] issued on 19 August 2024 determining the quantum, the High Court has for the first time clarified how equitable compensation should be calculated where a director breaches their fiduciary duties to the company while continuing to trade after the point at which liquidation is probable.

The English High Court concluded that equitable compensation under section 212 of the Insolvency Act 1986 (**IA 1986**) relating to a breach of the equitable duty to have regard to creditors' interests when a company is in the zone of insolvency, is calculated according to the increased net deficiency in the company's assets incurred during the period of misfeasant trading and caused by the breach of duty. This mirrors the approach the court takes when calculating the level of contribution to the insolvency estate a director should make following a finding of wrongful trading under section 214 of the IA 1986[3].

Traditionally, claims relating to trading in the zone of insolvency have been brought as wrongful trading claims. The threshold for liability in that case is that the director continued trading after the point at which they knew, or ought to have known, that there was *no reasonable prospect* of avoiding insolvent administration or insolvent liquidation[4]. However, following the UK Supreme Court's decision in *Sequana*, misfeasant trading offers a previously under-explored cause of action. In the case of misfeasant trading, the June 2024 Judgment held that only the probability of insolvent administration or liquidation is required.

With wrongful trading and misfeasant trading potentially leading to identical awards - albeit with a lower bar for bringing misfeasant trading claims, - we expect to see more misfeasant trading claims in the future; particularly given the relative rarity of successful wrongful trading claims.

1. Background to the BHS litigation

BHS – a traditional High Street retail department store – was established in 1928 and became a household name in the UK.

In the decade prior to its collapse, its profitability declined and by 2015 it had a cumulative operating loss of £442 million. In March 2015, Retail Acquisitions Limited purchased the entire issued share capital of the parent company, British Home Stores Group Ltd, for £1. New directors were

1 *BTI 2014 LLC v Sequana SA and others* [2022] UKSC 25
2 *Wright and Rowley, BHS and others v Chappell and others* [2024] EWHC 2166 (Ch).
3 See *Re Ralls Builders Ltd (in liquidation)* [2016] EWHC 1812 (Ch)
4 The director must also have failed to take every step to minimise losses to creditors.

appointed to the BHS companies. Following a further unsuccessful trading period, the BHS companies entered administration in April 2016.

The liquidators brought various claims against the directors, which for convenience can be divided into the following categories:

- wrongful trading
- misfeasant trading
- further misfeasance claims

2. The June 2024 Judgment

In the June 2024 Judgment, each director was ordered to pay £6.5 million for continuing to trade past the point at which the Court concluded the directors knew, or ought to have known, that insolvency was inevitable and there was no reasonable prospect of avoiding liquidation (i.e., they engaged in wrongful trading). The directors also were ordered to compensate the companies for breaching their directors' duties by continuing to trade the companies past the (earlier) point in time at which they ought to have concluded that an insolvency process was probable.

The court made key findings of fact and law on various issues of liability and causation in respect of both wrongful trading and misfeasant trading – the latter being a cause of action that was explored for the first time in this case[5]. This judgment deals with the quantum payable in respect of the misfeasant trading finding.

3. Causation

In terms of the relevant test to apply, the court confirmed there was "*no reason to depart from the usual measure of compensation and that the breaches of duty which [the directors] committed were the effective cause of the total ["increase in net deficiency"]*" (or **IND**). The court would then apply a "*but for*" test when assessing losses arising from the breaches of duty. In other words, if the losses would have happened in any event, then the relevant breach cannot be said to have caused the loss.

Specifically, the burden was on the liquidators to prove that the directors' breach of duty was "*an effective cause*" of the loss for which they sought a contribution, although it did not need to be "*the sole or only effective cause*" of loss.

The court ultimately concluded that:

> "*…those breaches of duty were not just the but for cause of the Companies' continuing to trade but an effective cause of the total IND and, in particular, the property and trading losses which the Companies suffered…Indeed, I am satisfied that those breaches of duty were the principal if not the sole effective cause of those losses.*"[6]

4. Calculating the quantum of liability

It was accepted by the parties that, in respect of both misfeasant and wrongful trading, the starting point for determining what contribution the directors should be ordered to make to the companies' assets was the IND in the assets of the company following the relevant liability being triggered.

The parties agreed that on 26 June 2015 (the date on which the court held that the directors had sufficient knowledge such that misfeasant trading was triggered) and the date of administration (25 April 2016), the IND was approximately £133.5 million. However, the Court would need to consider whether, but for the breach of duty, a loss of £133.5 would have occurred.

The increase in the pension scheme deficit (£19 million) failed the 'but for' test, as the pension position was demonstrably volatile. A double recovery must also be avoided. The court therefore deducted the increase in the pension deficit of £19 million, and sums paid by directors in settlement of claims against them.

Taking this into consideration, the court held the directors jointly and severally liable to pay equitable compensation for misfeasant trading in the sum of £110,230,000.

In case the High Court was wrong in determining the basis of compensation, the court offered two alternative approaches to calculating quantum:

5 *Re BHS Group Ltd & Others* [2024] EWHC 1417 (Ch)

6 At para [54].

i. Aggregate decreases in the value of assets and increases in liabilities, i.e., the decrease in value of the companies' property assets, the increase in other liabilities, and the decrease in other assets, less credit for sums received in settlement, or
ii. By reference to the loss caused by individual transactions

3. Joint and several liability

In determining the incidence of equitable compensation, the court held that the directors should be jointly and severally liable for the losses. This is consistent with the well-established principle in English law that trustees should be jointly and severally liable for loss where they are involved in a collective breach of their duties.

The court considered whether it could exercise discretion to impose liability on a several basis only. Interestingly, the court's view was that such an apportionment may not be available in misfeasant trading cases, stating that:

> "*I doubt whether such discretion is wide enough to enable the Court to impose liability on a several basis rather than a joint and several basis or to limit an award of equitable compensation for breach of the statutory duties of a director once a liquidator has proved liability to the civil standard*."[7]

The question of whether the court has a discretion to apportion liability for misfeasant trading was ultimately left unresolved.

4. Trading in the zone of insolvency: overlap between wrongful trading and misfeasant trading

The award for misfeasant trading awarded in this case (i.e., the IND of a company's assets during the period in which the company continued to trade) mirrors the approach taken in wrongful trading cases. However, unlike misfeasant trading, liability in respect of wrongful trading is subject to a strict "*knowledge test*" (i.e., a requirement that the directors knew, or ought to have known, that there was no reasonable prospect of the company avoiding insolvent liquidation or administration). Accordingly, the directors argued that in the future, liquidators may try to "*shoe-horn*" what should be wrongful trading claims into misfeasant trading claims in order to bypass the wrongful trading knowledge test.

In the court's view, however, the two heads of liability have different legal requirements and are not intended to be mutually exclusive. Therefore, the fact that liability for losses arising from misfeasant trading must fall within the scope of duties which have been breached should provide an "*adequate control mechanism to limit the overlap*".

5. Practical implications for directors

This decision is part of a developing and important area of law in the UK. It highlights that, not only are separate claims against directors possible arising from wrongful trading and misfeasant trading when a company is in the zone of insolvency, but the two actions have significant commonality. In all cases where potential liability is a concern, directors therefore should ensure they take independent professional advice.

Claims based on breach of duty misfeasant trading often will be easier to establish despite liability being calculated on the same basis as wrongful trading. Moreover, claims based on misfeasant trading potentially allow for a higher recovery because, at present, there is no established authority for apportioning liability between directors or finding directors severally liable for sums awarded pursuant to a misfeasant trading claim. This may give insolvency practitioners more scope for recovery where there are multiple defendant directors with differing levels of assets or, perhaps D&O cover.

On the other hand, notwithstanding the lower bar to establishing a claim, directors appear to have a wider defence to misfeasant trading claims compared with wrongful trading, as they need only show that they considered creditors' interests and, acting in good faith, concluded that continuing to trade was in creditors' best interests. Where wrongful trading is claimed, the statutory defence is much narrower i.e., that directors took *every* step with a view to minimising losses to creditors.

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7 At [40].

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