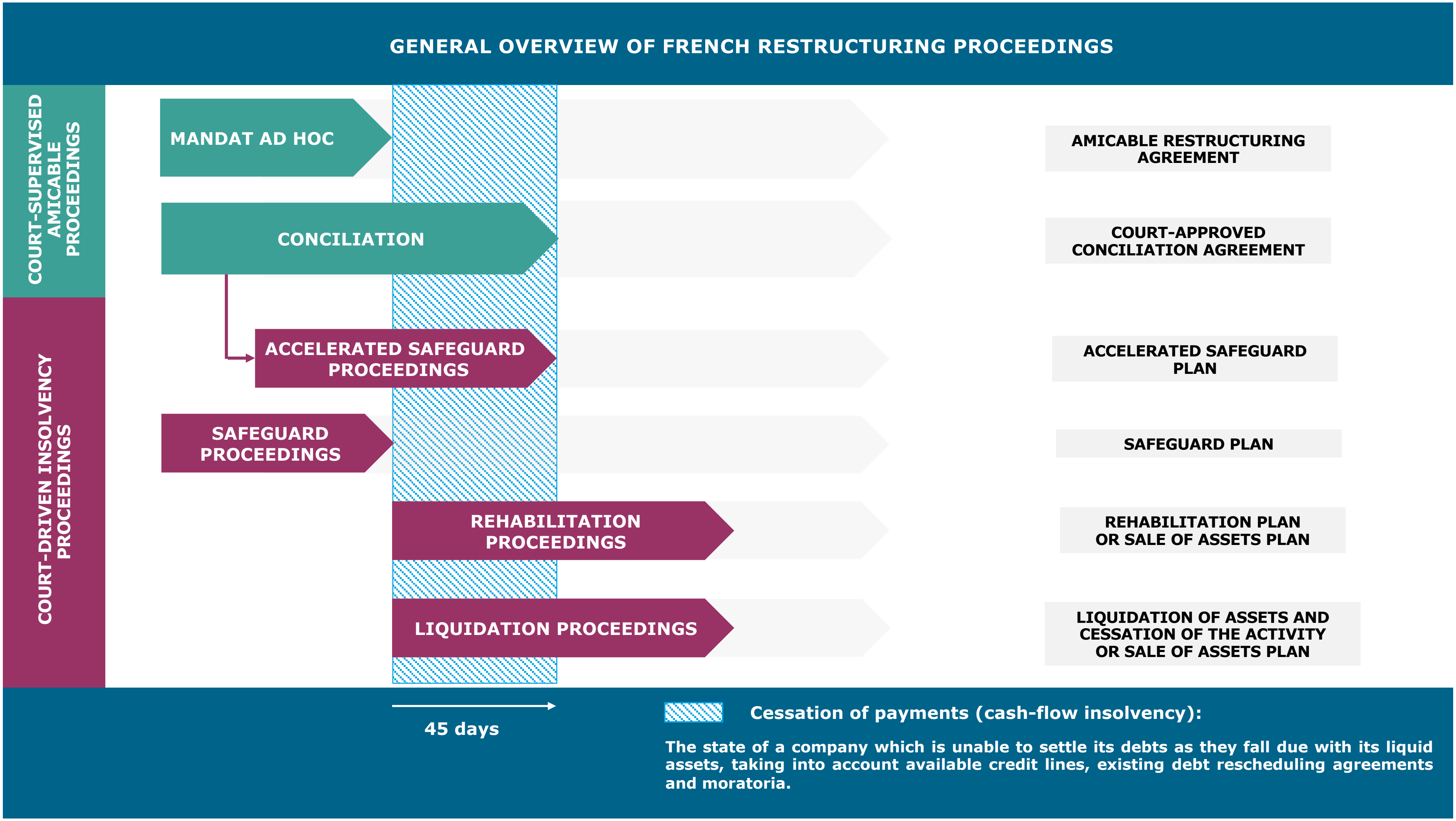

GENERAL OVERVIEW OF FRENCH RESTRUCTURING PROCEEDINGS
COURT-SUPERVISED AMICABLE PROCEEDINGS
COURT-DRIVEN INSOLVENCY PROCEEDINGS
MANDAT AD HOC
CONCILIATION
ACCELERATED SAFEGUARD PROCEEDINGS
SAFEGUARD PROCEEDINGS
REHABILITATION PROCEEDINGS
LIQUIDATION PROCEEDINGS
AMICABLE RESTRUCTURING AGREEMENT
COURT-APPROVED CONCILIATION AGREEMENT
ACCELERATED SAFEGUARD PLAN
SAFEGUARD PLAN
REHABILITATION PLAN OR SALE OF ASSETS PLAN
LIQUIDATION OF ASSETS AND CESSATION OF THE ACTIVITY OR SALE OF ASSETS PLAN
45 days
Cessation of payments (cash-flow insolvency):
The state of a company which is unable to settle its debts as they fall due with its liquid assets, taking into account available credit lines, existing debt rescheduling agreements and moratoria.

KEY FEATURES OF FRENCH COURT-SUPERVISED AMICABLE PROCEEDINGS

MANDAT AD HOC	CONCILIATION

Common Features

- Their purpose is to provide a **negotiation framework under the aegis of an independent court-appointed third party** (the "*mandataire ad hoc*" or the "*conciliateur*") for the company to negotiate a restructuring agreement with its main stakeholders.

- These proceedings mostly take place **out-of-court**. Consequently, French law provides that these processes are **confidential** (i.e., the court decision opening such proceedings is not published and all the parties involved in the process are bound by a duty of confidentiality), and **do not entail a general stay on the claims** (i.e., moratoria should be agreed on a purely voluntary basis through standstill agreements).

- These amicable proceedings are **purely optional** for the company. As a result, during the whole proceedings, the **officers and directors** in place at the time of the proceedings **keep all their powers** and **remain fully in charge of the management** of the company. They especially represent the company during the negotiations held under the aegis of the *mandataire ad hoc* or the conciliator.

- In this context, the *mandataire ad hoc* or the conciliator merely **assists** the company to define the best way forward and, when negotiations take place, **acts as an independent "referee"** providing the parties with its expertise and credibility, so as to facilitate the conclusion of a restructuring agreement. The *mandataire ad hoc* or the conciliator has **no power to impose restructuring measures** to the company or its creditors: these measures must therefore be agreed by the creditors **on an unanimous basis** (or any other applicable majority the parties have contractually agreed beforehand, if any).

Specific Features

MANDAT AD HOC

- Mandat ad hoc proceedings are available to any company which:
  - ➢ is **not in cessation of payments**; and
  - ➢ faces **any type of difficulty.**

- Mandat ad hoc proceedings have **no time limit** (these proceedings are in practice generally opened for an initial period of 3 to 6 months, renewable several times).

- **No legal protection of the debtor against creditors** during the proceedings or in the context of an agreement.

CONCILIATION

- Conciliation proceedings are available to any company which:
  - ➢ is not in cessation of payment or **have not been in cessation of payments for more than 45 days**; and
  - ➢ faces "**legal, economic or financial difficulties, whether actual or foreseeable**".

- Conciliation proceedings are limited to **a maximum of 5 months.**

- **Protection of the debtor during the proceedings:**
  - ➢ Possibility, under certain conditions, to force a dissenting creditor to suspend payment of his claim for the duration of the conciliation proceedings and/or request the president of the court, through an adversarial process, to impose a rescheduling of the payment of such creditor's claim for a duration of up to 2 years;
  - ➢ Impossibility for a creditor to request the opening of rehabilitation or liquidation proceeding against the debtor during the whole duration of the conciliation proceedings.

- The parties may obtain a court-approval of their restructuring agreement either through a "constat" or an "homologation". The "**homologation**" of the restructuring agreement allows the parties who have provided new money through debt-financing to the company to benefit from the **new money privilege** and, to a certain extent, protects the transactions made by the distressed company against the risks of avoidance on the basis of French **claw-back provisions.**

KEY FEATURES OF FRENCH COURT-DRIVEN INSOLVENCY PROCEEDINGS

	SAFEGUARD PROCEEDINGS	REHABILITATION & LIQUIDATION PROCEEDINGS

Common Features

- These proceedings are **public** and basically entail a **general stay of payments** of all claims that arose prior to the judgment opening such proceedings (subject to limited exceptions), the creditors being under an obligation to file a proof of claim (including a description of their security interest as the case may be) to preserve their rights in the process.
- **A supervisory judge** is appointed to oversee the smooth running of the proceedings and authorize specific acts.

Specific Features

SAFEGUARD PROCEEDINGS

- **Opening conditions:**
  - Accelerated safeguard proceedings: if the parties fail to reach a restructuring agreement on a consensual basis **in the context of a conciliation,** managers can petition the court for the opening of accelerated safeguard proceedings with a view to imposing an agreement on the dissenting creditors.
  - Safeguard proceedings: **if the company is not in cessation of payments but experiences difficulties that it is not able to overcome**, it can petition the court for the opening of safeguard proceedings.

- Impact on the **operational management** of the company: **monitoring** (ie., a posteriori supervision of the main management of the decisions) **or assistance** (ie., double signing of the key operations) **of a judicial administrator.**

- **Outcomes**:
  - Accelerated safeguard proceedings: **all the creditors concerned by the proceedings** (that may be picked up by the debtor prior to the opening of the proceedings) are collectively consulted on a reorganisation plan **through a class-based system**. If the plan is not adopted within the required time limit, the proceedings will automatically terminate with no possibility for the court to impose a term-out.
  - Safeguard proceedings: the rules of adoption of a restructuring plan basically differ depending on the size of the companies concerned:
    - In companies with fewer than 250 employees and €20 million turnover or €40 million turnover, the creditors whose payment terms are affected by the proposed restructuring plan are, in principle, consulted on the plan on an **individual basis.** They can be imposed a term-out over a maximum period of 10 years by the court.
    - In companies exceeding these thresholds the creditors and, as the case may be, equity holders whose rights (or equity interest) are affected by the proposed restructuring plan are consulted within **classes of affected parties.** These classes are constituted based on certain criteria such as a sufficient economic interest test, compliance with intercreditor and subordination agreements and the requirement that secured creditors, unsecured creditors and equity holders (if affected by the plan) vote in separate classes.

    If no agreement is found on a plan through the class-based system or the plan is not approved by the court, **the ordinary safeguard proceedings** are directly converted into rehabilitation or liquidation proceedings.

REHABILITATION & LIQUIDATION PROCEEDINGS

- **Opening conditions**: **if the company is in cessation of payments**, its managers will be under an obligation to petition the court within **45 days** for the opening of **rehabilitation proceedings** (if the company has **reasonable prospects of recovery**) or **liquidation proceedings** (if the company has **no chance of recovery**).

- Impact on the **operational management** of the company:
  - rehabilitation proceedings: the judicial administrator can either be in charge of **assisting** the corporate officers and directors with the management of the company, or be in charge of **all or part of the management** of the business.
  - liquidation proceedings: the opening of the proceedings automatically and immediately **deprives the officers and directors from all their management powers** and results in the immediate cessation of the activity (unless the Court decides otherwise for a certain limit of time – in such case, the liquidator will be in charge of the management of the business).
- **Outcomes:**
  - rehabilitation proceedings**:**
    - the adoption of a **rehabilitation plan** based on rules that are essentially the same as in ordinary safeguard proceedings, subject to a few notable exceptions:
      - any affected party has the right to present an alternative restructuring plan that may compete with the debtor's;
      - the cross-class cramdown may be implemented without the debtor's consent; and
      - if no agreement is found on a plan through the class-based system, the creditors must be re-consulted pursuant to the individual consultation process in the framework of which the court may notably impose a 10-year term-out to dissenting creditors.
    - a **sale of assets plan** aiming at selling to a third party all or part of the company's assets as a going-concern pursuant to a court-supervised sale procedure (taking the form of an open-bid process).
  - liquidation proceedings: it is designed to **sell the company's assets and settle its debts**, but can also end up with the adoption of a **sale of assets plan** by the Court.

OVERVIEW OF SPECIFIC LIABILITY RISKS FOR DIRECTORS UNDER FRENCH INSOLVENCY LAW

CIVIL LIABILITY

Liability for the company's shortfall of assets

If judicial liquidation proceedings ultimately result in a shortfall of assets against the company's debts and the court determines that this shortfall is attributable to a **mismanagement** ("faute de gestion") on the part of **de jure or de facto managers**, the court may decide that such managers shall bear jointly or severally whole or part of this shortfall of assets.

The action may be brought **by the judicial liquidator** or the **public prosecutor**. A majority of the creditors appointed as "controller" ("contrôleur") are entitled to initiate such a claim if they unsuccessfully requested the judicial liquidator to initiate such claim.

<u>Types of mismanagement include:</u>

- management decisions contrary to the company's interest;
- breaches of corporate duties; and
- inadequate management.

The court has the **sovereign power** to assess damages to be paid by the relevant manager(s), capped at the total net liabilities of the company at the end of liquidation proceedings (i.e., taking into account the net proceeds of the liquidation).

Personal disqualification & prohibition of managing

(*"faillite personnelle"* & *"interdiction de gérer"*)

If a court orders "*faillite personnelle*" against a manager, this manager **is prohibited from, directly or indirectly, running, managing, administrating or controlling any company** legal entity for the duration defined by the court but limited to 15 years.

This manager may additionally be barred from carrying out any public mandate as resulting from an election (for a maximum duration of 5 years).

When **rehabilitation or liquidation proceedings** have been opened, the court may order "*faillite personnelle*" against any manager if he :

- abusively operated an unprofitable activity that had necessarily lead to the company's cessation of payments;
- selled property belonging to the legal entity as his own;
- payed or caused someone else to pay a creditor, after cessation of payments and while being aware of this, to the prejudice of other creditors.

The court may also **bar a manager** if he has:

- Acted in bad faith;
- Failed to request the opening of a conciliation;
- Not paid the amounts he was ordered by the court pursuant to an action in liability for deficiency of assets.

This action may be brought by the **creditor's representative, the judicial liquidator** or **the public prosecutor** or, under certain conditions, a creditor appointed as "**controller**" ("*contrôleur*").

CRIMINAL LIABILITY

Faudulent mismanagement (« *banqueroute* »)

When **judicial rehabilitation** or **liquidation proceedings** have been opened, a manager may be found guilty of "banqueroute", if the court finds that he/she has:

- purchased goods in order to resell them at an undervalue or used ruinous means to obtain funds, with the intent to avoid or delay the opening of a judicial rehabilitation or liquidation proceeding;
- embezzled assets;
- fraudulently increased liabilities;
- held fictitious accounting;
- or disposed of accounting documents with the intent to avoid or delay insolvency proceedings.

This offence is punished by imprisonment for a duration up to **5 years** and by a fine of an amount up to **€75,000** (which is increased to 7 years and €100,000 when the debtor provides investment services).

Managers found guilty of "banqueroute" **may face additional penalties** like deprivation of civic rights and prohibition from public mandates or professional activities.

Other criminal liability

A manager may face imprisonment for a duration up to 2 years and a fine of an amount up to €30,000 if he/she has:

- **paid pre-filing claims**, **granted a security-interest**, or **disposed of certain assets** after the opening of insolvency proceedings and without obtaining the consent of the supervising judge as required by the law; or
- **paid a creditor**, or **disposed of certain assets**, in breach of the terms of the discharge of liabilities provided in an approved safeguard or rehabilitation plan.

Beneficiaries of such breaches may also be liable to the same extent than the managers.

Manager's relatives may face imprisonment up to **3 years** and a fine of up to **€375,000** for removing, disposing, or concealing assets of the debtor during insolvency proceedings.

Help Center

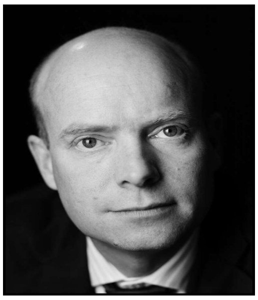
AMERICAN BANKRUPTCY INSTITUTE

An Introduction to the Dutch Scheme and an Overview of the First Rulings Since Its Enactment

Committee: International

Sits Schreurs

RESOR N.V.; Amsterdam, The Netherlands



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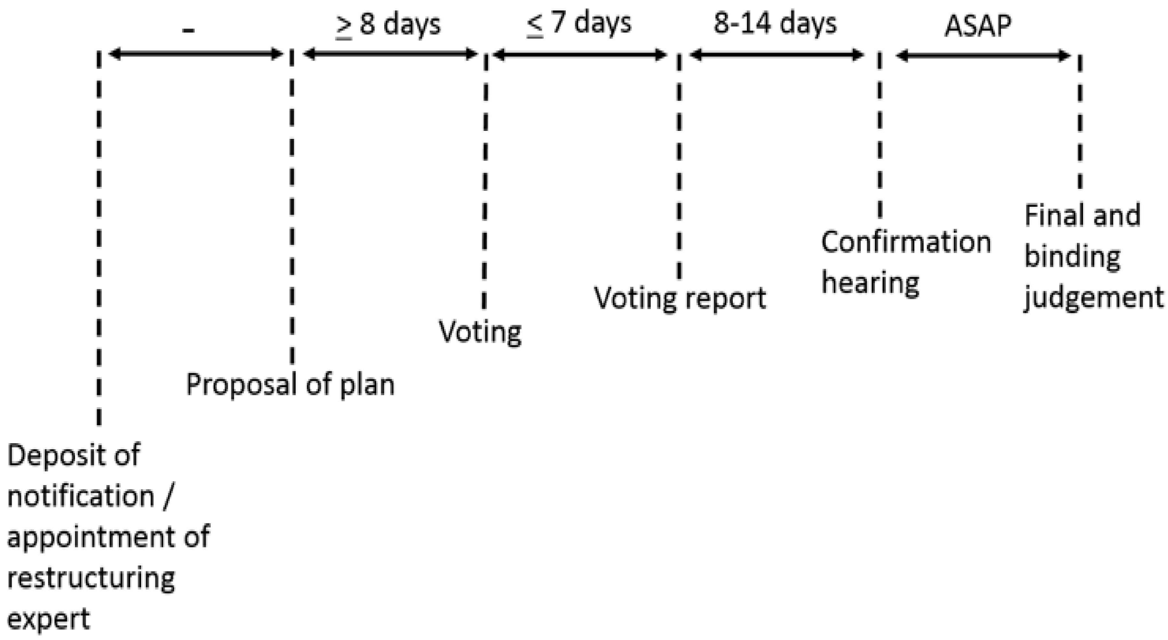
On Jan. 1, 2021, the Dutch Act on the Confirmation of Private Plans (hereafter referred to by its Dutch acronym, "WHOA," or the "Dutch Scheme") entered into force. It represents a robust and flexible restructuring framework. This brief article provides a summary of the Dutch Scheme and an update about the first published cases involving the scheme.

Dutch Scheme Inspired by U.S. Chapter 11 Reorganization Plan

The Dutch Scheme provides an instrument to facilitate court confirmation of a private plan to restructure a business's capital structure, so that creditors and/or shareholders who did not accept the plan can nevertheless be bound by it (with the exemption of rights of employees).[1]

A debtor is eligible for this procedure if it can reasonably be assumed that he will not be able to proceed paying his debts as they fall due.[2] The Dutch Scheme procedure can be initiated by both the debtor and a court-appointed restructuring expert.[3] The capital providers whose rights will be amended are the only ones with voting rights.[4] For purposes of voting, the respective different types of creditors and shareholders are divided into classes based on their rank and interests.[5] Based on this voting procedure, a two-thirds majority of a class can impose its will on the minority.[6]

Under the Dutch Scheme, the debtor or restructuring expert can opt to offer the plan in a private or public procedure. If the debtor starts the preparation of a plan, he deposits a notification thereof with the court registry.[7] From this moment onward, the debtor can call in a number of flanking measures. No preceding creditors' meeting or court entry test is required. After preparing the plan, the debtor presents it to its respective capital providers for a vote. Voting on the plan commences eight days afterward at the earliest. [8] Within seven days after voting, the debtor draws up a report and submits this at the court registry for inspection.[9] Between eight and 14 days after (1) submission of this report and (2) the debtor submitting a request for court approval of the composition plan, the court hearing for approval of the composition plan is held.[10] Until the day of the hearing, creditors can file a motion to reject approval of the plan.[11]The court renders its judgments as quickly as possible,[12] and no appeal is allowed. The entire procedure can expectedly be finalized within four to five weeks at the earliest after submitting the plan. For an overview of the procedure, see the timeline below.



Dissenting capital providers are protected. At the request of one or more capital providers — in a class that has voted in favor of the plan — the court will refuse the request to confirm the plan if the shareholder or creditor in question were to acquire rights that are significantly lower in value than the payment they are expected to receive upon liquidation of the debtor's assets (liquidation value), *i.e.*, inspired by the U.S.'s best-interest-of-creditors test.[13]

The plan can be submitted to the court for confirmation if at least one (on the basis of liquidation value "in the money") class of capital providers has accepted it.[14] The plan can be imposed upon any dissenting classes; this cramdown possibility is also inspired by the U.S. system. This confirmation is subject to conditions that may be invoked at the (explicit) request of one or more dissenting capital providers from a dissenting class.[15] The key principle is that the value of the reorganized debtor (reorganization value) must be distributed across the different classes under the plan in accordance with their statutory or contractual order of priority — *i.e.*, inspired by the U.S.'s absolute priority rule.[16]

This is different compared to, *e.g.*, the new U.K. Part 26A Restructuring Plan, where the court, for the purpose of the cramdown, must be satisfied that, (condition a) if the plan is sanctioned, none of the members of the dissenting class would be any worse off than they would be in the "relevant alternative"; and (condition b) the plan has been approved by at least one class who would receive a payment or have a genuine economic interest in the company in the event of the "relevant alternative," which is "*whatever the court considers* *would be most likely to occur in relation to the company if the compromise of arrangement were not sanctioned….*"

Whereas under the new U.K. Part 26A Restructuring Plan one has to analyze — on the day of reckoning — the value available if the compromise of arrangement were *not* sanctioned, under the Dutch Scheme (like chapter 11) the value of the reorganized debtor — *i.e.*, the value of the company if the restructuring plan *will* come about — is the relevant parameter for the purpose of the cramdown analysis.[17]

First Cases

If one analyzes the first published cases on the Dutch Scheme, a number of interesting conclusions can be drawn. It appears from case law that the vast majority of the cases concern small SMEs, even including sole traders, while the legislator (and also the academic literature) expected that mostly large companies would (be able) to use the Dutch Scheme as a restructuring tool. In most of those cases it is the debtor itself that initiated the procedure, and not an external party such as a large financial creditor. Applying the Dutch Scheme is thus less of a financial burden and practically more feasible than was anticipated.

From case law, it further follows that debtors are not very reluctant to ask courts to appoint an restructuring expert, while at first it seemed more likely that mainly external parties (creditors, working councils) would make such request. Courts have emphasized that the restructuring expert should act completely independently from all parties involved, even though the applicant may, as part of its request, indicate which persons he/she thinks would be suited for the role of restructuring expert. Courts have shown that they check very carefully whether the persons proposed are indeed independent and seem to attach considerable weight to circumstances that may threaten that independence.[18] For instance, courts have decided that the risk is too high that the person proposed would not act independently because this person had already assisted the applicant in an earlier stage of the restructuring procedure; because the request for a particular person was made on the office paper of the firm for which that same person was working; and because the person proposed had already invoiced costs for work done for the applicant.[19] The courts have expressed that an applicant should basically only make contact with the person he seeks to propose to the extent to which this is strictly necessary for composing a fee quote (as this should be part of the request to the court).[20]

Another recurring element in case law is the completeness and the comprehensibility of the information provided as part of the plan.[21] During hearings, judges have asked standard questions such as what the liquidation value of the debtor is, but also specific questions about items on the balance sheet and who the owner of a certain building is.[22] In one case, the insufficiency of the information led the court to deny a request to confirm a plan. Among other things, the debtor in that case had not informed the creditors about the (possible) existence of a debt it had, and the financial reports it had submitted contained incorrect figures.[23] The test underlying this assessment is whether creditors and shareholders are able to make an informed decision on the plan proposed.[24]

Most cases that have been published so far relate to the stay that can be ordered to facilitate preparing and proposing the restructuring plan. An important condition to grant a request for a stay (and to which the courts also pay the most attention in their decisions) is that the stay should be in the interest of the joint creditors. To that end, the courts, in each of their decisions, assess whether the joint creditors would be better off with a (Dutch Scheme) plan than with the alternative scenario, in most cases the bankruptcy of the debtor. If the plan scenario likely leads to a better result for the creditors (provides a "clear plus," to put in the practical words of one court[25]), then ordering a stay, which facilitates the realization of a plan scenario, meets the interests of the joint creditors.[26]

A last interesting point that follows from the current case law is the manner and the situations in which the courts make use of the observer, which has happened in a number of cases now.[27] In short, the observer monitors the preparations for the plan with an eye to the interests of the joint creditors.[28] For that purpose, the courts have appointed an observer in a case in which there was a conflict within the board of the debtor that initiated the plan proceedings, and, in another case, because it thought that the provision of information (until then) was insufficient. In one case, the term for the stay was relatively long, and some persons involved were both creditor and member of the board of the debtor, which could lead to a conflict of interest.[29]

International Aspects of the Dutch Scheme

As mentioned above, under the Dutch Scheme the debtor or restructuring expert can opt to offer the plan in a private or public procedure. This choice affects when the plan procedure falls within the scope of the European Insolvency Regulation (EIR) or not, as the EIR only applies to public proceedings.

Public Procedure: EIR

For the public procedure, the Dutch courts have jurisdiction if the centre of main interests of the debtor is located in the Netherlands.[30] The opening of the plan procedure and its consequences, including a possible stay, are automatically recognized in all countries of the European Union with the exception of Denmark.[31]

There are also disadvantages to the application of the EIR. Under the EIR, the Dutch court has fewer options to assume jurisdiction than under Dutch private international law (see below). Also, article 8 EIR restricts the effects of the plan and a stay versus creditors that have a security right over assets of the debtor that are located outside the Netherlands. Under the EIR the Dutch plan procedure does not affect such security rights over foreign assets.

Private Procedure: Domestic Private International Law

For a private proceeding, the Dutch court must establish its jurisdiction according to the Dutch Civil Code (DCC), which gives the general rules for jurisdiction for petitions and leaves the courts with a lot of freedom to determine jurisdiction. The Dutch court has jurisdiction if the petitioner or one of the interested parties has its place of residence, place of business, or usual residence in the Netherlands. The court can also assume jurisdiction if there otherwise is sufficient connection with the Dutch jurisdiction. The Dutch legislator listed several circumstances that — each individually — lead to sufficient connection:[32]

- the debtor has his centre of main interests or an establishment in the Netherlands;
- the debtor has substantial assets in the Netherlands;
- a (substantial) part of the debts that would be part of the plan follow from obligations that are governed by Dutch law or for which a choice of forum is made for the Dutch courts;
- a (substantial) part of the group that the debtor is part of consists of companies located in the Netherlands; or
- the debtor is liable for debts of another debtor for which the Dutch courts have jurisdiction.

A private plan is not eligible for automatic recognition within the EU. Recognition of the plan therefore depends on the private international law of the country in which recognition is requested.

Concluding Remarks

We make the following concluding remarks about the Dutch Scheme:

- It provides for a fast, efficient and highly flexible instrument with all the powers required to reconfigure the capital structure as appropriate, whilst preserving the business throughout;
- The fact that others besides the debtor (controlled by out-of-the-money equity) can initiate the procedure enhances early intervention;
- The instrument enables creditors to preserve and realize the value of the business on a nondistressed basis;
- The instrument enables existing equity to inject new money into the business and thus to protect its investment by facilitating the elimination of unsupported debt; and
- The availability of a variant that falls within the EIR and a variant that falls outside the EIR, with very broad jurisdiction, makes the instrument particularly useful for dealing with cross-border groups. The variant that falls within the EIR offers the benefit of automatic recognition. The variant that falls outside of the EIR can be used where the EIR is problematic because of the existence of security rights on foreign assets (rights *in rem* exception) or because of the COMI of guarantors or other group members being located in different jurisdictions. This enables a cross-border group to be restructured through proceedings in a single jurisdiction.

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[1] An English translation of the bill is *available at* **https://resor.nl/dutch-scheme**.

[2] Section 370(1) Dutch Bankruptcy Code (hereinafter "DBC").

[3] Section 370(1) and 371(1) DBC.

[4] Section 381(3) DBC.

[5] Section 374 DBC.

[6] Section 381(7) DBC.

[7] Section 370(3) DBC.

[8] Section 381(10) DBC.

[9] Section 382 DBC.

[10] Section 383(6) DBC.

[11] Section 383(8) DBC.

[12] Section 384(1) DBC.

[13] Section 384(3) DBC.

[14] Section 383(1) DBC.

[15] Section 384(3-4) DBC.

[16] See the explanatory memorandum to the original bill: *Parliamentary Papers II* 2018/19, 35 249, 3, p. 5 (hereafter: Explanatory Memorandum).

[17] Section 384(4) DBC.

[18] District court Northern Netherlands 19 January 2021, ECLI:NL:RBNNE:2021:111; District court Northern Netherlands 26 January 2021, ECLI:NLRBNNE:2021:244; District court Northern Netherlands 29 January 2021, ECLI:NL: RBNNE:2021:285; District court The Hague 5 March 2021, ECLI:NL:RBDHA:2021:2033; District court Central Netherlands 26 March 2021, ECLI:NL:RBMNE:2021:1255; District court The Hague 1 April 2021, ECLI:NL: RBDHA:2021:3228; District court Central Netherlands 19 March 2021, ECLI:NL:RBMNE:2021:113; and District court The Hague 25 May 2021, ECLI:NL:RBDHA:2021:5316.

[19] *See*, in particular, District court Northern Netherlands 26 January 2021, ECLI:NLRBNNE:2021:244 and District court The Hague 25 May 2021, ECLI:NL:RBDHA:2021:5316.

[20] District court Northern Netherlands 26 January 2021, ECLI:NLRBNNE:2021:244; this also follows in a more general sense from the case referred to above.

[21] District court Northern Holland 19 February 2021, ECLI:NL:RBNHO:2021:1398; District court Gelderland 21 January 2021, ECLI:NL:RBGEL:2021:363; and District court Gelderland 4 March, ECLI:NL:RBGEL:2021:2343.

[22] District court Northern Holland 19 February 2021, ECLI:NL:RBNHO:2021:1398; District court Gelderland 21 January 2021, ECLI:NL:RBGEL:2021:363.

[23] District court The Hague 2 March 2021, ECLI:NL:RBDHA:2021:1798.

[24] Explanatory Memorandum, p. 12.

[25] District court Rotterdam 8 March 2021, ECLI:NL:RBROT:2021:1887.

[26] District court The Hague 15 January 2021, ECLI:NL:RBDHA:2021:198; District court Amsterdam 15 January 2021, ECLI:NL:RBAMS:2021:84; District court Gelderland 21 January 2021, ECLI:NL:RBGEL:2021:363; District court Northern Netherlands 29 January 2021, ECLI:NL:RBNNE:2021:509; District court Gelderland 4 March 2021, ECLI:NL:RBGEL:2021:1126; District court The Hague 2 April 2021, ECLI:NL:RBDHA:2021:3227; District court Rotterdam 8 March 2021, ECLI:NL:RBROT:2021:1887; District court The Hague 25 May 2021, ECLI:NL: RBDHA:2021:5316; District court Overijssel 16 July 2021, ECLI:NL:RBOVE:2021:2907; District court The Hague 9 July 2021, ECLI:NL:RBDHA:2021:7143; and District court Amsterdam 11 March, ECLI:NL:RBAMS:2021:3331.

[27] District court Amsterdam 15 January 2021, ECLI:NL:RBAMS:2021:84; District court The Hague 2 April 2021, ECLI:NL:RBDHA:2021:3227; District court Gelderland 4 March 2021, ECLI:NL:2021:2343; and District court Amsterdam 26 May 2021, ECLI:NL:RBAMS:2021:2815.

[28] Section 380 DBC.

[29] *See* the case law mentioned above.

[30] Section 3 EIR.

[31] Section 19 and 32 EIR.

[32] Section 3 Dutch Code Civil Procedure.

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Your restructuring regime or mine?

In July 2021, we put forward many reasons why we see Ireland as an obvious contender for collaboration with the UK in cross-border restructurings in our previous Digest contribution [*Everybody needs good (restructuring) neighbours*]. The case for this is now stronger given the recent changes to the Irish regime under the European Union (Preventative Restructuring) Regulations 2022 SI 380/2022 (the **Regulations**), which bring further similarities with the UK restructuring regime than ever before.

Before the implementation of the Regulations, Ireland already had a number of tried and tested restructuring tools which were broadly in line with the key elements of the Regulations (i.e. a debtor in possession remedy, the ability to implement a cross-class cram-down and the concept of a "relevant alternative" for the purposes of analysing unfair prejudice). These have been utilised in a number of large-scale complex cross-border restructurings to date.[1] Some of the changes made are not radical to these concepts embedded in the Irish examinership regime, which is more than 30 years old. However, we can expect a more streamlined interpretation and approach to the case law between the UK and Ireland when determining issues in our respective processes.

Ireland is the only EU jurisdiction that can avail itself of statutory recognition in the form of foreign recognition assistance under section 426 of the Insolvency Act 1986 to achieve inbound recognition in the UK. This will no doubt be helpful to UK practitioners who, in light of Brexit, are forced to consider other regimes in Europe to overcome recognition issues in other jurisdictions.

While the Regulations are not implemented in England, the addition of the restructuring plan to the UK's restructuring toolbox has aligned its insolvency regime with many of its European neighbours, whilst also maintaining the UK's status as an international restructuring hub. Since its introduction by the Corporate Insolvency and Governance Act 2020 (**CIGA**), there have been 11 restructuring plans sanctioned, and one declined, giving rise to a body of precedent dealing with issues such as treatment of out-of-the-money creditors and valuation issues in the context of the "relevant alternative" comparator.

Ireland – what has changed?

A detailed explanation of Ireland's restructuring regime is set out in our previous Digest contribution [link]. On 29 July 2022, the European Union (Preventative Restructuring) Regulations 2022 were signed, bringing into effect Directive (EU) 2019/1023 and leading to a number of changes to the examinership legislation under the (Irish) Companies Act 2014 (the **Irish Companies Act**)[2] including the introduction of a "best-interests-of-creditors" test and amendments to voting rights for "out-of-the-money" creditors.

By virtue of the Regulations, the Irish examinership regime now incorporates a "best-interests-of-creditors" test which needs to be considered at two key stages of the examinership process: (i) in preparation for and on petitioning for examinership; and (ii) when seeking confirmation of the examiner's proposals for a scheme of arrangement. While not defined in the Irish Companies Act (or in the Regulations), the best-interests-of-creditors test is defined in the Directive as one which is "*satisfied if <u>no dissenting creditor would be worse off</u> under a restructuring plan than such a creditor would be if the normal ranking of liquidation priorities under national law were applied, either in the event of liquidation, whether piecemeal or by sale as a going concern, or in the event of the next-best-alternative scenario if the restructuring plan were not confirmed*" (emphasis added).

The "best-interests-of-creditors" test is very similar to the "no worse off" test which is part of the cross-class cram-down statutory mechanism under the UK restructuring plan.[3] As in Ireland, when a court is tasked with sanctioning an examiner's proposals for a scheme of arrangement, the English court may exercise its power to sanction a restructuring plan, notwithstanding that it has not been approved by the requisite majority in each meeting of creditors or members. This is provided that the court is satisfied that none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative.

Before the Regulations, a petition for Irish examinership needed to be accompanied by an opinion from an independent expert (being either the relevant company's auditor or another person qualified to be appointed as an examiner or liquidator of the company) covering: (i) the reasonableness of a company's prospects of survival; and (ii) whether an attempt to continue the company (in whole or part) "*would be likely to be more advantageous to the members as a whole and the creditors as a whole than a winding-up*" of that company (emphasis added).

By virtue of the Regulations, however, the independent expert must now opine on whether an attempt to continue the undertaking "*meets the best-interest-of-creditors test and would be likely to be more advantageous to the members <u>as a whole</u> than a winding-up of the company*" (emphasis added)[4]. In doing so, the independent expert is now mandated not to limit his or her analysis to a benchmark liquidation scenario, but to broaden this to include a next best alternative scenario for dissenting creditors in the event that the proposals are not sanctioned.

As we have seen from the recent body of Part 26A cases, the relevant alternative is whatever the court considers would be most likely to occur in relation to the company if the restructuring plan were not sanctioned (similar to the "next best alternative scenario" definition in the Directive). The court need only be satisfied as to that alternative scenario on the balance of probabilities (*Virgin Active*[5]). While there is no requirement for an independent expert's opinion to accompany an application under Part 26A, the cases to date have established the critical importance of having thorough valuation evidence to withstand careful interrogation of the relevant alternative before such an application is made.

Alternative scenarios

In contested Part 26A cases, we have seen valuation evidence being filed by dissenters and financial advisers being cross-examined (Virgin Active). What the relevant alternative is will be a question of fact and, as determined by cases in both Ireland and England, it is not necessarily liquidation (as in *DeepOcean*[6]). Other relevant alternatives have included a pre-pack administration sale (*PizzaExpress*[7]), trading insolvency and sale (*Virgin Active*), managed wind-down (*Hurricane*[8]), a receiver controlled workout (*McInerney Homes Limited*[9]) and could include other consensual outcomes e.g. an accelerated M&A. As to the requirement to reflect "*the normal ranking of liquidation priorities under national law*", in the recent case of *Re Houst* we saw the English court held that a departure from the usual priority rule is not, of itself, "*fatal to the success of the plan*"[10].

These are issues with which the examiner typically grappled at sanction stage to show that the proposals were not unfairly prejudicial to any interested party. However, as the independent expert is now obliged to opine on whether the "best-interests-of-creditors" test has been met, this would appear to be a heavier burden than previously existed. A robust next-best-alternative analysis for dissenting creditors at the petition stage may not be possible, or may be purely hypothetical. This could give rise to further challenge about how nuanced this analysis ought to be, which of course will depend on information available to the independent expert at that stage in the process.

Creditors' voting rights

The Regulations have also made significant changes to the way in which creditor voting rights in an Irish examinership have worked to date.

1. *Mallinckrodt plc, Norwegian Air, Cityjet and Re Weatherford Group.*
2. Not all of which will be covered in this article.
3. Section 901(G) CIGA.
4. Amending section 511(3)(g) of the Irish Companies Act.
5. In *Re Virgin Active Holdings Ltd and others* [2021] EWHC 1246 (Ch).
6. In *Re DeepOcean 1 UK Ltd and others* [2021] EWHC 138 (Ch).
7. In *Re PizzaExpress Financing 2 plc* [2020] EWHC 2873 (Ch).
8. In *Re Hurricane Energy Plc* [2021] EWHC 1759 (Ch).
9. In *Re McInerney Homes Limited* [2011] IESC 31.
10. *Re Houst Ltd* [2022] EWHC 1941 (Ch) [30].

Previously, the court could confirm proposals for a compromise or scheme of arrangement if: (i) the proposals were accepted by a simple majority of one class of creditors whose rights would be impaired by the implementation of the proposals; (ii) the court was satisfied that the proposals were fair and equitable in relation to any impaired dissenting class of members or creditors; and (iii) the proposals are not unfairly prejudicial to the interests of any interested party.

The Companies Act now expressly provides that unimpaired creditors cannot vote on an examiner's proposals for a scheme of arrangement.[11] Additionally, while it remains the case in an examinership that approval of only one class of impaired creditors is required (requiring a simple majority in number and value of that creditor class), the examiner cannot count any creditor vote where any such creditor *"would not receive any payment or keep any interest in a liquidation scenario"*.

The position under the Companies Act is similar in scope to Condition B to the cross-class cram-down mechanism under a restructuring plan, requiring an "in-the-money" class to vote in favour. This is a significant departure from the previous position under Irish examinership whereby "out-of-the-money" impaired classes would typically vote in favour of the proposals (and could therefore be the single class relied upon for sanction purposes) by virtue of receiving some dividend, however small, under the proposals. In the UK, the position of "out-of-the-money" creditors goes even further in that, where the court is satisfied that a class of creditors or members has no genuine economic interest in the company, the court may order for that class of creditors or members to be excluded from the plan meeting(s).[12]

This change with respect to "out-of-the-money" creditors' voting rights is likely to lead to greater scrutiny on behalf of both the examiner, when formulating his or her proposals, and the court on issues of class composition. In this specific context, some wariness on behalf of the English courts has been shown on the issue of class manipulation and engineering classes in such a way so as to create an artificial class group of "in-the-money" creditors to vote in favour of a plan (for example, with a group of creditors who would have been prepared to enter into a consensual arrangement to restructure their rights). In Re Houst, the court warned against the temptation of plan proponents to artificially "create an in-the-money class for the purposes of providing an anchor to activate the cross-class cram-down power …".[13]

11. *Section 540(4A) of the Irish Companies Act.*

12. *Section 901(C) CIGA.*

13. *Re Houst Ltd [2022] EWHC 1941 (Ch) [20].*

Potential for further valuation and disclosure battles?

At the heart of restructurings is a valuation analysis that the company is worth more continuing as a going concern than being liquidated.

In the case of restructuring plans under Part 26A, the burden is on the plan proponent, typically the company, to establish the "no worse off" test on the balance of probabilities. In Irish examinership, the examiner formulates proposals, having undertaken an investigation of the company on its viability and sought out bids for investment. The examiner has the burden of proving that the proposals do not unfairly prejudice the interests of creditors. As an independent officer of the court, the examiner is under a duty to consider all external bids. Even where the senior lenders and the company have reached a consensual deal to restructure the company's debts, or where that class has otherwise established a plan for the enforcement of its security, the examiner must still consider any bids received from third parties during the process and decide, using his or her commercial judgement, which is the optimum bid to ensure the company's survival and pass the legal thresholds for creditor and court approval.

Questions of valuation and the "next best"/ "relevant" alternative are critical to the sanction of any scheme or plan which imposes a cram-down. Valuation issues also come into focus where active members or creditors want greater scrutiny and disclosure on where value breaks to prove potential recoveries in alternatives in order to have a seat at the table for negotiating and ultimately voting power in respect of the proposals. The courts in each jurisdiction have, through a number of cases, given guidance for opposing creditors and plan proponents on how valuation disputes and disclosure issues that arise during the process will be dealt with. For example:

- While there is a balancing exercise to ensure that "...the potential utility of Part 26A is not undermined by lengthy valuation disputes", it is clear that "the protection for dissenting creditors given by the 'no worse off' test (and the Court's general discretion) must be preserved" (Virgin Active).[14]

- Opposing creditors or members should raise issues at the convening stage rather than postpone their objection to sanction stage for tactical reasons and act expediently to request any financial information, if seeking to deploy such information in expert evidence (Smile Telecoms[15]).

- With regard to disclosure issues, plan proponents should "co-operate in the timely provision of information". Where the information is commercially sensitive, confidentiality undertakings are usually provided (Virgin Active).

  It has been acknowledged in the context of restructuring plans that "it would be most unfortunate if Part 26A plans were to become the subject of frequent interlocutory disputes".[16] However, the English courts have demonstrated that the practicalities of providing information in a compressed timeframe can be overcome. In Virgin Active, the court ordered the submission of witness evidence, response evidence, a pre-trial hearing and a sanction hearing to take place over a bank holiday weekend so as not to disrupt an ambitious plan timetable.

- Given the very short statutory timeline (currently up to 150 days) in Irish examinership within which the examiner must present his or her proposals to court for sanction, as a practical matter, interlocutories and other pre-trial procedures such as discovery must be pragmatically dealt with. While an examinership deadline is tight, the importance of cross-examination, particularly where there are wildly conflicting versions of facts deposed to on affidavit, has been underlined by examinership case law (*Re McInerney Homes*). On seeking further information from an examiner on materials which are already before the court, to date the examiner, as an officer of the court, has been entitled to rely on his or her commercial judgement on whether this should be provided. Unless such a decision falls foul of the Edennote utterly unreasonable/ absurd standard, it is unlikely to be interfered with (*Re Ladbrokes (Irl) Ltd*).[17]

Ipso facto clauses

Another important harmonious development between the two jurisdictions is the introduction in Ireland of a ban on creditors withholding, terminating, accelerating or modifying an executory contract when a company is in examinership, solely because the company is in examinership. The ban is not limited to an "essential executory contract" and remains in place for as long as the company is in examinership and under court protection.[18] Prior to the Regulations, a party was allowed to terminate or modify contracts upon the occurrence of certain events of default, such as a counterparty's insolvency or examinership.

Under English law, a new section 233B of the Insolvency Act introduced by CIGA similarly restricts a supplier of goods or services to a company in a formal rescue or other insolvency procedure (but not schemes of arrangement) to vary or terminate the contract by virtue of that company's entry into a formal process. As in Ireland, the supplier is prohibited from demanding payment of outstanding pre-insolvency liabilities as a condition of continuing supply. If the supplier was entitled to terminate before the company went into an insolvency process, it cannot exercise that right during such process.

14. *Re Virgin Active Holdings Ltd and others [2021] EWHC 1246 (Ch) [130].*

15. *Re Smile Telecoms Holdings Ltd [2022] EWHC 740 (Ch).*

16. *Re Virgin Active Holdings Ltd and others [2021] EWHC 1246 (Ch) [131].*

17. *Re Ladbrokes (Irl) Ltd & Ors [2015] IEHC 381.*

18. *Section 520A(1) and 520A(2) of the Irish Companies Act.*

However, unlike the position in Ireland, termination in England is possible if the company or an insolvency office holder agrees, or the court finds, that continuation of the contract would cause the supplier "hardship". Section 233B supplements the pre-existing regime under section 233A which provides that an insolvency-related termination of contract for the supply of "essential goods or services" ceases to have effect when a company enters administration or CVA, where suppliers are able to demand a personal guarantee from the officeholder for post-insolvency charges.

While there is a corresponding prohibition on an examiner from terminating a contract solely because the company is in examinership, it remains to be seen to what extent the ban on ipso facto clauses will be successfully challenged by counterparties. Underpinning the ban is a policy of corporate rescue being implemented throughout Europe. It is emboldened by another example of a derogation from the principle of contractual freedom in the Irish examinership regime, namely the company's power to repudiate executory contracts during the process.[19] In order for a company to avail itself of the power to repudiate in an examinership: (i) the contract must be executory (i.e. one where some element of performance other than the payment of money remains); and (ii) the company needs to establish that the repudiation is necessary in order to formulate proposals for a scheme of arrangement or the survival of the company as a going concern. In essence, the company must be in a position to prove that its survival will be prejudiced if the repudiation is not effected.

Given that a company's right to repudiate a contract under the examinership legislation has previously survived challenges based on, among other things, an infringement of property rights (*Re Linen Supply Ireland Ltd*[20]), we expect that Regulation's introduction into Irish law of a ban on ipso facto clauses to similarly survive any such challenge.

Directors' duties on insolvency or likely insolvency

The Regulations have introduced into the Irish Companies Act a new statutory duty on directors who "believe" or who have "reasonable cause to believe" that a company is or is likely to be unable to pay its debts (under both an as-they-fall-due test or balance sheet insolvency test).[21] Under Irish law, such directors are required to "have regard to", among other things, "*the interests of creditors*" and "*the need to take steps to avoid insolvency*". This duty is expressed to be owed by directors to the company "*and the company alone*" and is enforceable in the same way as any other fiduciary duty owed to a company by its directors (e.g. by derivative action). Before now, a duty to have regard to creditor interests in a company's insolvency or likely insolvency existed at common law only and as to whom precisely this duty was owed was not as clear.

In English law, the general duties owed by a director to the company are codified in sections 171 to 177 of the Companies Act 2006, based on certain common law rules and equitable principles relating to directors. Section 172(1) of the Companies Act requires directors to act

19. *Section 537 of the Irish Companies Act.*

20. *In Re Linen Supply Ireland Ltd [2010] IEHC 28.*

21. *Section 22A of the Irish Companies Act.*

in the way that they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. Section 172(3) makes the duty under section 172(1) "*subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company*". At common law, directors are required, as part of their fiduciary duties to the company, to consider, and in some cases prioritise over shareholder interests, creditor interests under what is known as the "creditors' interests duty" or the rule in *West Mercia*.[22]

The existence of the "creditors' interests duty", its trigger point and scope was recently considered by the Supreme Court in Sequana.[23] The Supreme Court confirmed that the "creditors' interests duty" arises when directors know or ought to know the company is insolvent or bordering on insolvency, or insolvent liquidation or administration is probable. Where the "creditors' interests duty" is triggered, directors must give consideration and weight to creditor interests in a manner that is appropriate or proportionate to the circumstances of the company. This must be balanced against other stakeholders, including members. However, once insolvency is inevitable, creditors' interests are paramount.

In both jurisdictions, the subjectivity of a director's knowledge or belief of a company's insolvency or likely insolvency will invariably raise issues, as will the question of what giving "consideration to" or "having regard to" actually means in the context of creditors' interests. Recent case law in Ireland has attempted to answer the latter (albeit in a different context) finding that "*having regard to implies looking at the matter concerned and factoring in its relevance, if any, and weight, if any, as those matters appear to the decision-maker*" and that "*expressions like consider, take into account and have regard to all mean the same thing*".[24]

Neighbourly cooperation

England and Ireland are common law English-speaking jurisdictions with highly regarded judicial systems and specialist practitioners on both sides of the Irish Sea. The sophistication of our respective restructuring regimes has been borne out by a considerable body of significant cross-border restructuring cases in recent years. For UK processes, a parallel process with a European jurisdiction may be required in order to secure pan-European recognition. An Irish insolvency process is the only European process that can avail statutory recognition in the UK under section 426(4) of the Insolvency Act 1986. The similarities between and robustness of our respective processes should give ample scope to working together in troubling times.

22. *West Mercia Safetywear Ltd v Dodd [1988] BCLC 250.*

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

24. *Cork County Council v Minister for Local Government, Planning and others [2021] IEHC 683.*

KIRKLAND & ELLIS

Kirkland Alert

Galapagos: English Court Fully Upholds Validity of 2019 Restructuring, on Proper Construction of "Distressed Disposal" Provisions in Intercreditor Agreement

01 August 2023

At a Glance

The English Court ruled in favour of the Galapagos group on Friday, 28 July, in a dispute as to whether the c.€1 billion restructuring of the Galapagos group in 2019 was validly effected in accordance with the terms of an English law intercreditor agreement (ICA).

This case marks the first test of "Distressed Disposal" provisions in English law ICAs since *Stabilus* (2012)[1] (previously the most significant case in this area).

Signal, a holder of the group's €250m high yield notes (HYNs) — the liabilities under which were fully released via the restructuring by the security agent by exercising its rights under the "Distressed Disposal" provisions in the ICA — has brought proceedings opposing the validity of the restructuring across multiple jurisdictions for several years, including in Germany, Luxembourg and the U.S.

In granting the declarations sought by the Galapagos group, the court held that, under the relevant Distressed Disposal provision:

- the requirement that the proceeds of the sale/disposal must be in cash or substantially in cash was satisfied in circumstances in which the purchase consideration was partly paid by way of a consensual, contractual set-off of funds (i.e., the proceeds of the enforcement being reinvested by senior creditors that supported the transaction lending that money back to the post-restructured group);

- the requirement that creditors' claims/security must be unconditionally released concurrently with a Distressed Disposal was satisfied in circumstances in which the newco purchaser issued new debt securities to the group's existing creditors — in other words, the court held that the holders of debt securities *are* able to participate in the financing of the restructured group under the terms of the market-standard ICA;
- accordingly, the restructuring was validly effected under the Distressed Disposal provision;
- it was therefore unnecessary to determine the group's "fall-back" case, that a term should be implied into the Distressed Disposal provision such that its conditions should not apply if the HYNs were "out-of-the-money"; but
- in any case, the HYNs *were* as a matter of fact "out-of-the-money" at the time of the Distressed Disposal.

This decision offers significant guidance as to the proper interpretation of Distressed Disposal provisions in ICAs. It also offers comfort to debtor groups and their senior creditors that using such provisions "works", validly releasing junior creditors' claims as part of a restructuring.

In particular, from a wider market perspective, the decision in this landmark case underlines the effectiveness of the distressed disposal mechanics that are typical within English law intercreditor agreements in most European leveraged financing transactions as the basis for delivering out-of-court restructuring transactions outside bankruptcy processes.

Kirkland represented the Galapagos group in its restructuring and have represented the group in the subsequent litigation across the various jurisdictions, including in the English proceedings.

Background

The Galapagos group restructured in October 2019. In summary, the following steps were taken with the consent and support of the overwhelming majority of the group's senior creditors:

- directors of the parent company applied to the English Court for an administration order after events of default occurred under the group's senior secured notes (SSNs) when the group failed to pay interest and to deliver audited financial statements;

- a sales process was commenced for the purpose of selling key secured assets;
- the SSN holders accelerated repayment and issued enforcement instructions to the security agent;
- the security agent enforced the security and agreed to sell the key secured assets — including shares in Galapagos Bidco — to the highest bidder, with a "backstop" bid of c.€425 million from the group's existing sponsor;
- pursuant to the waterfall in the ICA, the senior lenders and SSN holders were repaid;
- the security agent exercised its contractual power under the Distressed Disposal provisions of the ICA to release the remaining claims — namely, those arising under the HYNs, the most subordinated tranche of the group's financial indebtedness;
    - in essence, the Distressed Disposal provision required that — unless >50% of the HYN holders approved the disposal (which they did not) — each of the following conditions must be satisfied for a Distressed Disposal (if the guarantees/security in respect of the HYNs were to be released):

        (A) the proceeds of the sale/disposal must be in cash or substantially in cash;

        (B) concurrently, creditors' claims against relevant group members and relevant security must be unconditionally released and discharged; **and**

        (C) the sale/disposal must either be made pursuant to a public auction or a financial advisers' opinion be obtained — it was common ground that this condition was satisfied;

- accordingly, the purchaser — a newco controlled by the group's existing sponsor — acquired the group (through an investment of new money) free of the liabilities under the HYNs; and
- the new group (Mangrove) entered into new financing arrangements on the same day with a number of its existing senior creditors and sponsor.

As noted, the central issue in these proceedings was whether the restructuring was validly effected in accordance with the ICA, which revolved around satisfaction of conditions (A) and (B) above.

The new group sought a court order to state that such conditions were satisfied; Signal, a holder of c.€73 million of the HYNs, sought a court order to state that the conditions had not been satisfied and therefore the releases were of no effect.

The following proceedings are separate but related to this challenge.

- *New York claim*: Signal brought a claim in New York against Galapagos Bidco and various parties, alleging a conspiracy to defraud the HYN holders; those proceedings have been stayed (since July 2020) pending determination of these English proceedings.
- *Insolvency proceedings in respect of former parent*: Galapagos S.A., the old group's interim holding company, is in English liquidation proceedings. It is purportedly also in German insolvency proceedings, commenced by certain HYN holders. The validity of these proceedings has been subject to a protracted challenge. The Court of Justice of the European Union ruled that the German court had no jurisdiction to open insolvency proceedings, given there was a pre-existing administration application in England and the effect of the European Insolvency Regulation. However, the German courts have nevertheless allowed the German insolvency to continue after Brexit, though the English Court has refused to recognise the German insolvency proceedings.
- *Claw-back action within German insolvency proceedings*: the purported German insolvency officeholder sought a "claw-back action" to reverse the share sale and the deed of release under which the HYN liabilities were released. Those proceedings have recently been dismissed.

Judgment

There were essentially three core issues, on which the court ruled as follows — granting most of the declarations sought by the group.

Issue	*Summary*	*Judgment*
1. **Cash consideration** — Condition (A)	Whether the sale of secured assets pursuant to the restructuring was made for consideration "in cash (or substantially in cash)" for the purposes of the ICA Signal asserted that this condition was not satisfied because the purchase price for the key secured assets was paid,	The fact that a majority of the holders of the SSNs chose to reinvest their share of that sum in the new notes did not mean that the issue of the new notes were themselves to be treated as consideration for the disposal. There was no reason in principle why the SSN

in part (c.65%), by way of set-off.[2]

Galapagos Bidco did not dispute that the actual payment was partially effected by way of set-off, but it did not accept that this meant that the proceeds of the sale were not in cash or substantially in cash.

holders should not be entitled to do whatever they liked with the money they received through the waterfall under the ICA, including subscribing for new debt securities.

The mere fact that a substantial part of the consideration for the Distressed Disposal was applied by way of set-off did not mean that the proceeds were not "in cash (or substantially in cash)" for the purposes of condition (A). It was the promise to pay in cash which generated the proceeds of the sale/disposal; there was nothing to restrict any holder of the SSNs from re-lending those proceeds by directing that the cash which it would otherwise receive under the distribution waterfall should instead be applied as a set-off against the subscription price for the new notes.

"In short there is no reason in principle why the proceeds in the present case cannot be treated as being "in cash" if what occurs has the

		legal effect of discharging by set-off the obligation which arose under the promise to pay." "The operation of a legal set-off should be regarded for the purposes of condition (A) as having precisely the same effect" as payment "in cash", provided both sums are both liquidated and certain. "The real purpose of condition (A) is to ensure that the proceeds of the Distressed Disposal are identified and valued in cash." Accordingly, condition (A) was satisfied.
2. **Validity of release of claims / security** – Condition (B)	Whether as part of the restructuring all the claims of the existing creditors against the Galapagos Group were "unconditionally released and discharged" and "not assumed by the purchaser or one of its Affiliates", and whether all security under the Security Documents was "simultaneously and unconditionally released" for the purposes of the ICA	There was nothing in this condition to prevent existing creditors from agreeing to lend money to the new group. On proper construction, the claims under the new debt instruments were held by the re-subscribing noteholders / lenders in a different capacity and under different debt documents with different terms. Their existing creditor rights did not give rise to any

This condition effectively required the security agent to sell the relevant shares on a debt-free basis — i.e., creditors' claims must be released, together with security in respect of those claims. A sale for nominal consideration (but subject to existing indebtedness) is therefore not permitted.[3]

Signal asserted this condition was not satisfied because the substance of the transaction left a significant number of existing creditors as creditors of the new Mangrove group.

claims by them as creditors within the meaning of condition (B).

It was an "unjustified leap in logic" to argue that existing creditors could no longer be creditors of the new group under alternative financing arrangements following the Distressed Disposal — even where the re-lending was made in a prearranged manner in conjunction with the sale.

To hold otherwise would be "a wholly uncommercial consequence", because it would seriously restrict creditors' ability to obtain a recovery on their claims, by removing from the potential pool of refinancing those creditors who are most likely to have an appetite to continue to support the group with new finance. "There is little commercial sense in restricting the ability of the senior creditors to contribute finance to fund [the] survival and future development [of the underlying business], whether by the restatement of their existing exposures on new terms, or by the advance of wholly new money."

Further, to hold otherwise would also have a very significant adverse impact on the senior creditors' rights to utilise the funds to which they were entitled under the distribution waterfall in their own interests; it would give the holders of the HYNs a very significant negotiating position extending well beyond any legitimate interest they might have in ensuring that the value of the underlying business is realised in full.

The fact that the releases formed part of a series of interlinked restructuring steps did not mean that each release was anything other than an unconditional release and discharge. The correct question was whether, at a time concurrent with the sale effecting the Distressed Disposal, creditors' claims against

		the relevant member of the group were unconditionally released and discharged. Accordingly, condition (B) was satisfied.
3. **Implied term in Distressed Disposal provision?**	(A) Whether a term should be implied into the Distressed Disposal provision of the ICA to the effect that the conditions in that provision are not required to be satisfied if the HYN holders are "out-of-the-money"[4]; and (B) if so, whether the HYN holders were so "out-of-the-money" This was a "fall-back" argument adopted by the group, in case it did not succeed on issues 1 and 2 above. The purported German insolvency officeholder argued that the English court should not decide this point at all, as it was a question of fact on issues which were also before the German court (in the claw-back action).	It was unnecessary to determine this question given the court's rulings on issues 1 and 2 above. However, it was nonetheless appropriate to make findings of fact on the "out-of-the-money" issue, for various reasons. On the potential implied term: the ICA could operate satisfactorily without implying the suggested term, and it was important to construe the ICA in a way which provides for a reasonable degree of commercial certainty and predictability. These factors (among others) pointed against the implication of the suggested term — and, more generally, against a construction of the ICA which would disapply the need to satisfy conditions (A), (B) and (C) if the HYN

holders were "out-of-the-money".

However, the court went on to consider whether, if it was wrong on the above point of construction, the HYNs were in fact "out-of-the-money". It held that:

- there was very clear evidence that, in absence of the Distressed Disposal, a formal insolvency was likely to occur;
- the strong likelihood was that there was no real prospect of a sale being agreed other than on the terms of the Distressed Disposal (or substantially those terms);
- it was unrealistic for Signal to point to things that the existing sponsor or senior creditors could have done to improve the group's prospects of survival; such actions essentially involved either advancing further funding or deferring creditors' enforcement rights, when there was no evidence these other

stakeholders would have been prepared to do so;

- for junior creditors (here, the HYN holders) to be considered "in-the-money" requires clear evidence sufficient to prove, on the balance of probabilities, that they would receive a return in the event that the restructuring does not proceed;
- in this case, the available evidence did not demonstrate that, if the proposed Distressed Disposal failed, the group would somehow have been supported for sufficient time to enable another orderly sale to proceed; and
- instead, a liquidation sale was the likely counterfactual in the absence of the planned Distressed Disposal — in which the HYN holders would have been "out-of-the-money".

Accordingly, the HYN holders were "out-of-the-money" at the time of the Distressed Disposal.

The court also held that there is no general principle of contractual construction that, if there is ambiguity in a clause which is potentially “expropriatory”, then the ambiguity should be resolved against taking away property rights. Instead, the relevant question is which construction is more consistent with business common sense:

> “Where an agreement such as the ICA regulates the relationship between creditors, business common sense may well point to a construction which preserves the rights of the senior creditors as against the junior creditors, even if in so doing the junior creditors are no longer able to enforce their claims against the debtor or receive the benefit of security to which they would otherwise be entitled. … The rights of the holders of the HYNs to initiate enforcement and receive any proceeds from the operation of the payment waterfall have always been restricted by their ranking.”

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1. *Saltri III Ltd v MD Mezzanine SA SICAR* (2012) ↩

2. The payment by set-off occurred because certain creditors who were entitled to receive a share of the sale proceeds under the ICA’s distribution waterfall opted to lend money back to the new Mangrove group for the purpose of funding the business after the sale. This obligation to make payment under the waterfall was then discharged by way of set-off. ↩

3. Absent a contractual provision to this effect, that is a course open to a security agent to take: *Stabilus* at [122]. ↩

4. In the sense that the HYN holders have no economic interest in shared security/debtors’ assets and would receive no return if the Distressed Disposal did not occur. ↩

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Kirkland Alert

Wirecard: German District Court Rules Shareholder Damages Claims Are Effectively Subordinated in an Insolvency of the Issuer

28 November 2022

At a Glance

The Munich District Court last week delivered a first-instance verdict in the multi-billion euro *Wirecard* insolvency[1], that shareholder damages claims arising from (in particular) a breach of capital markets law rank as equity in German insolvency proceedings, behind all creditors' claims.

The ranking of shareholder damages claims is an important building block for any downside analysis of investors in public companies with their centre of main interest (COMI) in Germany. This judgment establishes that shareholders' damages claims would rank behind creditors' claims; accordingly, such claims would be unlikely to obtain a recovery in any insolvency proceedings and would not operate to "dilute" creditors' recoveries.

Judgment

Wirecard was a German DAX 30 fintech star that filed for insolvency in June 2020 after disclosing that the existence of €1.9 billion in cash, about one quarter of Wirecard's balance sheet, could not be confirmed. Wirecard shareholders have filed about 40,000 claims in the insolvency proceedings, seeking damages of roughly €7 billion for capital markets fraud and similar breaches.

The Munich District Court dismissed a shareholder's claim for recognition of his claims as general unsecured claims in the insolvency and held as follows.

- Shareholder damages claims are economically equivalent to a claim for the reimbursement of equity contributions. Therefore, in the insolvency waterfall, shareholder damages claims are to be treated like equity, ranking behind general unsecured and subordinated insolvency claims.

- Shareholder damages claims need to be distinguished from fraud-related damages claims by debt investors which the German Federal Court of Justice (*Bundesgerichtshof*) treats as general unsecured claims in an insolvency.
  - In 2006 (and again in 2022), the Federal Court ruled that investors who subscribed to subordinated profit participation rights (*Genussrechte*) after being misled about the issuer's financial situation have a general unsecured claim in the insolvency of the issuer. Profit participation rights are (hybrid) debt capital.
  - According to the Munich District Court's judgment in *Wirecard*, misled equity investors and misled debt investors need to be treated differently in an insolvency: it is not relevant that both are capital markets participants who have been misled. Equity investors consciously opt for the risk of subordination in an insolvency in return for a (potentially unlimited) participation in the issuer's profits, while debt investors accept a limited upside in return for priority in the event of insolvency.

- The treatment of shareholder damages claims in an insolvency further needs to be distinguished from their treatment outside an insolvency and the related case law of the Federal Court.
  - In *EM.TV* (2005), the Federal Court ruled that, at least in cases of intentional misconduct, capital markets law takes precedence over corporate law, so that shareholder damages claims are enforceable even if such enforcement otherwise violates capital maintenance requirements under German corporate law.
  - According to the Munich District Court's judgment in *Wirecard*, in the event of insolvency, the purpose of issuer liability for misinformation can no longer be realised, so that insolvency law takes precedence over capital markets law, and capital markets law no longer takes precedence over capital maintenance restrictions. Shareholder damages claims are subject to capital maintenance restrictions (which protect the company's equity capital in the interest of its creditors), i.e., they are to be treated like equity, and cannot be general unsecured claims in an insolvency.

Implications

The ranking of shareholder damages claims is an important building block for any downside analysis of investors in public companies with their centre of main interest (COMI) in Germany. This judgment establishes that shareholders' damages claims would rank behind creditors' claims; accordingly, such claims would be unlikely to obtain a recovery in any insolvency proceedings and would not operate to "dilute" creditors' recoveries. However, the parties to the *Wirecard* litigation are expected to take the matter all the way to the Federal Court. Until the Federal Court has rendered a final decision on the ranking of shareholder damages claims, no definitive guidance can be given, and caution is advised.

This judgment is the first to provide guidance on a fundamental question of German insolvency law that has, somewhat surprisingly, remained unresolved for decades. It comes at a time when German public companies are increasingly being targeted by investors and regulators for their capital markets communications.

The judgment was obtained by an affiliate of Kirkland & Ellis, acting as common representative of all holders of the €500 million bond issued by Wirecard AG and co-defending the insolvency estate against competing shareholder damages claims.

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1. LG München I, judgment dated 23 November 2022 - 29 O 7754/21. ↩

Related Professionals

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Debra I. Grassgreen is a senior partner in Pachulski Stang Ziehl & Jones LLP's San Francisco office and heads the firm's international insolvency practice. She is the immediate past president of the International Insolvency Institute (the first woman to be elected to that position), and she is widely regarded as a leading expert on cross-border restructuring matters, frequently speaking and writing on cross-border matters and others. Ms. Grassgreen has experience representing debtors, trustees and creditors' committees in large and complex chapter 11 cases nationwide and internationally in the technology, media, telecommunications and life sciences industries, both in and out of court. Some of her more notable engagements include representing solar power manufacturer Solyndra, American Suzuki Motor Corp., Mesa Airlines and the creditors (including abuse survivors) in the Weinstein Co. chapter 11 case. In addition, she has represented high-profile individuals, including boxer Mike Tyson and singer Toni Braxton, among others. Ms. Grassgreen is a Fellow in the American College of Bankruptcy Fellow and has held a variety of leadership positions in prestigious insolvency organizations, including the International Women's Insolvency & Restructuring Confederation (IWIRC) and the American College of Bankruptcy, having chaired its Insolvency Committee and currently serving as its Ninth Circuit Regent. For the past 10 years, she has participated in the United Nations Commission on International Trade Law's Working Group V and its expert group meetings as an NGO delegate. Ms. Grassgreen has been listed in the Los Angeles and San Francisco Daily Journal as one of the "Top Bankruptcy Lawyers" in California and, for several years, as one of its "Top Women Lawyers." In 2021, IWIRC selected her as its "Woman of the Year in Restructuring." She also holds Chambers USA's highest rank (Band 1) in Bankruptcy/Restructuring, and she is rated AV-Preeminent by Martindale-Hubbell. In addition, she is listed in Who's Who Legal: Thought Leaders—Global Elite and in Lawdragon as one of its 2022 and 2023 "500 Leading U.S. Bankruptcy & Restructuring Lawyers" and one of its 2020 "500 Leading Global Restructuring & Insolvency Lawyers," and she has been listed in The Best Lawyers in America every year since 2001 for her work in both

Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law and Litigation - Bankruptcy. Ms. Grassgreen received her B.S.B.A. in 1988 from the University of Florida, where she also received her J.D. with honors, and she is admitted to practice in Florida and California.

Gemma Freeman is a partner in Dentons' Dispute Resolution and Insolvency practice in Dublin, where she specializes in insolvency, corporate recovery-related litigation and shareholder disputes. She has advised private-equity firms, insolvency practitioners, company directors, stakeholders, liquidators and other fiduciaries on both contentious and noncontentious matters. Ms. Freeman has acted for both financial institutions and unsecured creditors of companies in financial distress and insolvency practitioners in a variety of formal insolvency processes, including compulsory and voluntary liquidations, receiverships, bankruptcy and examinerships. She has been recognized in Legal 500 for 2022 as Recommended in Insolvency and Corporate Restructuring, and she is a member of the International Women's Insolvency & Restructuring Confederation and INSOL. In addition, she is an accredited mediator by the Centre for Effective Dispute Resolution. Ms. Freeman is admitted to practice as an attorney-at-law by the Cayman Islands Legal Practitioner's Association, and as a solicitor by both the Law Society of England and Wales and the Law Society of Ireland.

Krijn Hoogenboezem is a partner with RESOR in Amsterdam, The Netherlands, where he specializes in corporate restructuring and insolvency, litigation and insurance law. He is a trusted advisor of boards in and out of crisis situations, and he has advised several multinational companies on restructurings and international financing arrangements. Mr. Hoogenboezem's litigation work includes banking (enforcement) and corporate litigation. He frequently represents the interests of insurers in complex, usually international, coverage issues, and he acts for clients in a wide range of sectors, including the energy, insurance and financial sectors. Mr. Hoogenboezem is regularly appointed as a bankruptcy trustee. Previously, he was a partner with Dentons. Mr. Hoogenboezem received his law degree from Utrecht University.

Alexandre Koenig is a partner with Stephenson Harwood LLP in Paris and heads the firm's restructuring and insolvency practice in France. A restructuring and insolvency and dispute resolution specialist, he advises and assists a wide range of French and international clients, including the various stakeholders faced with an insolvency situation or crisis (distressed companies, shareholders, creditors, debtors in difficulty, investors, purchasers, insolvency practitioners, etc.) on all aspects of restructuring and insolvency matters, whether it involves financial or operational restructurings or company takeovers, both in an amicable and judicial context. He also has leading-edge expertise in the prevention and handling of complex litigation related to restructurings or disposals of underperforming businesses, as well as business disputes arising out of crisis situations. Mr. Koenig has acted in emblematic cases in the industry, transport, technology, telecom, leisure, retail, real estate and construction, energy, publishing and media sectors. He was named as one of the best professionals aged under 40 in the world by the Global Restructuring Review in 2022, and his team was named among the "Firms to Watch" in insolvency by The Legal 500 EMEA in 2023. Mr. Koenig is a former secretary of the Conference of Lawyers at the Council of State and Court of Cassation. He is an active member of INSOL Europe and the Turnaround Management Association, and he is a Lexology National Expert. Prior to joining Stephenson Harwood, Mr. Koenig worked in the litigation and restructuring and insolvency practice of major international law firms in Paris. He notably was with Bredin Prat for more than seven years. Mr. Koenig speaks French and English and is a member of the Paris Bar. He is a graduate of the University of Paris II Panthéon-Assas, the University of Paris I Panthéon-Sorbonne and Sciences Po Paris.

Dr. Bernd Meyer-Löwy is a restructuring partner with Kirkland & Ellis International LLP in Munich, Germany. Before joining Kirkland, he worked for Linklaters Oppenhoff & Rädler as an insolvency practitioner. Dr. Meyer-Löwy has a wide range of cross-border restructuring and insolvency experience. He has acted for financial creditors, investors, turnaround advisors, debtors and insolvency practitioners in multi-jurisdictional restructurings and insolvency proceedings. Dr. Meyer-Löwy is qualified as a "special attorney for insolvency law" by Fachanwalt für Insolvenzrecht, and he has been ranked as one of the leading German insolvency lawyers in JUVE, Chambers Europe, Chambers Global, IFLR1000 and Handelsblatt Best Lawyers. He is a member of ABI and Arbeitskreis für Insolvenzwesen Köln e.V. Dr. Meyer-Löwy is admitted to practice in Germany as both an insolvency lawyer and a tax lawyer, and speaks German and English. He received his law degree and Dr. Jur. from Ruhr-Universität Bochum.