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GLOBAL INSIGHT

News, Views and Analysis from DLA Piper's Global Restructuring Group

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News Roundup

BARBARIANS AT THE (MARBLE)GATE? A RECENT DECISION FROM THE SDNY ADOPTS A BROAD INTERPRETATION OF THE TIA TO INHIBIT COERCIVE OUT-OF-COURT RESTRUCTURINGS

Restructurings are all about alternatives. It is one thing for a creditor to hold an instrument that entitles it to payment of $X on Y date. But if the debtor does not have the cash to satisfy the obligation when due, some type of restructuring must occur.

Whether the restructuring takes place in or out of court is, again, usually a function of alternatives. Does the restructuring have the support of creditors, and if so, which ones and how many? In the US, such considerations are often a primary determinant of whether a restructuring can be accomplished out of court or must undergo the formal chapter 11 process.

BACKGROUND

The Bankruptcy Code contains detailed provisions that limit how creditors' claims may be impaired under a chapter 11 plan. Included in the Bankruptcy Code are elaborate rules and mechanisms for the protection of creditors who may not support the restructuring, such as the "best interests" test, and the "cram-down" procedures. But which minimum standards apply to an out-of-court restructuring? How are minority interests protected there?

In the US, the Trust Indenture Act of 1939 (TIA) provides for certain protections to be granted to the holders of bonds issued under the TIA. Included among those protections are those set forth in TIA Section 316(b), which states that "the right of any Holder of a Note to receive payment of principal, premium…and interest on the Note…or to bring suit for the enforcement of such payment…*shall not be impaired or affected without the consent of such Holder.*" (emphasis added).

MARBLEGATE ASSET MANAGEMENT, LLC V EDUCATION MANAGEMENT CORP.

Recently, in *Marblegate Asset Management, LLC v. Education Management Corp*., the US District Court for the Southern District of New York addressed the question of whether an out-of-court debt restructuring violates Section 316(b) when it does not explicitly modify any payment term, but nonetheless leaves bondholders no choice but to accept the proposed modification to the terms of their bonds.

Marblegate involved an issuer, EDMC, that needed to restructure roughly $1.5 billion in debt. Since EDMC's business relied on federal student loan programs for the majority of its revenue, and access to those programs would cease upon a bankruptcy filing, an in-court restructuring through chapter 11 was not a viable option. Accordingly, EDMC launched an exchange offer and consent solicitation under which bondholders would receive different treatment, depending on the extent to which the exchange/consent offer was accepted.

If the offer achieved 100 percent bondholder acceptance, then the bonds would be converted into equity convertible into common stock of the issuer's parent-guarantor. But if less than 100 percent of the bondholders consented, then EDMC would implement an alternative restructuring under which its assets would be transferred to another subsidiary via a foreclosure sale by the senior lenders, and the parent guaranty would be released. Under this alternative, the nonconsenting bondholders would be left with recourse only against an issuer that then would be an empty shell.

In its decision, the court described the situation this way:

> The restructuring, supported and adopted by an overwhelming majority of bondholders, did not directly amend any term explicitly governing any individual bondholder's right to receive payment. Nevertheless, the restructuring gave dissenting bondholders a Hobson's choice: take the common stock, or take nothing. In effect, Marblegate bought a $14 million bond that the majority now attempts to turn into $5 million of stock, with consent procured only by threat of total deprivation.

Ultimately, the court held that the proposed restructuring violated Section 316(b). Relying heavily on the legislative history of the TIA, she found that the TIA is "meant to inhibit involuntary debt restructurings outside the formal mechanisms of bankruptcy." That is, the ruling endorsed the view that the TIA's protections are not merely procedural, i.e. protecting the right of bondholders to "bring suit for the enforcement of such payment," as the statute provides. Rather, the opinion says that the TIA provides more substantive protections, and was enacted "to prevent precisely the nonconsensual majoritarian debt restructuring that occurred here, even if the Act's authors did not anticipate precisely the mechanisms through which such a restructuring might occur."

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ANALYSIS

The Marblegate decision is significant, but not revolutionary, for several reasons. *First*, unlike the dramatic transaction proposed in the EDMC restructure, most out-of-court restructurings involve covenant strips, or other amendments, that do not remove valuable assets from bondholder recourse; the "Marblegate standard" should allow most of these restructurings to proceed. *Second*, Marblegate presented a fairly unusual fact pattern: since a chapter 11 filing would have destroyed the business, nonconsenting bondholders could not utilize their ability to exercise that option to block EDMC's plan, or negotiate a better deal.

Marblegate does, however, give issuers and bondholders something to think about. *The implications of the case go beyond SEC-registered bonds that are subject to the TIA*. This is so because many bonds issued without registration rights in "144A for life" transactions customarily contain indenture language similar to that of Section 316(b).

Since "144A for life" bonds are not required to contain the mandatory TIA provisions, issuers may seek to alter or remove those provisions in new debt. In particular, some issuers of 144A for life bonds may seek to sidestep the Marblegate problem by reducing the consent threshold for changes to "payment terms" below 100 percent, so as to provide more incentives for consent without the threat of asset-shifting and guarantee removals. Bondholders need to be wary of such changes, and be sure that they are adequately compensated for any increased risk posed thereby.

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RESOLVING AUSTRIA'S HETA – MAJOR MILESTONE FOR THE EUROPEAN BANK RESOLUTION REGIME

The first bank resolution under the new European bank resolution regime is currently taking place in Austria: the Austrian Financial Market Authority (FMA), the official government regulator for banks, funds and financial institutions, is busy with the resolution of HETA Asset Resolution AG (HETA - formerly Hypo Alpe-Adria Bank International AG). Hypo Alpe-Adria Bank International AG made headlines in 2008 for losing billions of euros; it was nationalized in 2009. The resolution of HETA represents a significant milestone for the European bank resolution regime, given that this is the first application of the regime therefore there is an absence of any practical experience in this area.

BACKGROUND - RESOLUTION OF HETA

The new European bank resolution regime is set out in the EU Directive on the Recovery and Resolution of Credit Institutions and Investment Firms (BRRD). The BRRD is transposed into Austrian law by the Federal Act on the Recovery and Resolution of Banks (BaSAG), which entered into force on 1 January 2015. The provisions regarding the preparation and execution of bank resolution measures constitute the centerpiece of the BaSAG which, *inter alia,* aim to ensure orderly resolution and preserve financial market stability in cases of failure (or threat of failure) of institutions subject to its regime. The FMA, in its role as the national resolution authority under the BaSAG, is responsible for orderly resolution in the public interest. To this end, the BaSAG provides the FMA with the following resolution tools:

- The sale-of-business tool;
- The establishment of a bridge institution tool (bridge bank);
- The separation-of–asset-positions tool (the creation of a bad bank);
- The moratorium tool; and
- The bailing-in-of-creditors tool (bail-in).

APPLICATION OF RESOLUTION TOOLS

The application of the resolution tools in HETA's case has been one of the most talked about issues of this year in Austria and across the EU. Starting at the beginning of 2015, HETA was subject to an asset quality review by external auditors. Based on this review it became apparent that HETA would require additional funding to avoid insolvency. As a result, HETA and the FMA asked the Republic of Austria (as HETA's owner) whether it would be willing to inject further capital into HETA. The government declined, and, consequently, the FMA assessed whether the legal requirements for a resolution of HETA were fulfilled and concluded that this was the case.

The FMA, in its role as the national resolution authority, issued an administrative decision on 1 March 2015 initiating the resolution of HETA in accordance with the BaSAG and the BRRD. In a nutshell, this administrative decision postponed the maturity of certain eligible liabilities of HETA towards its creditors pursuant to the BaSAG until 31 May 2016, thus deferring the due date of payments until 31 May 2016. The FMA therefore imposed a temporary moratorium on the debts, which in their view was necessary to prevent HETA's insolvency.

The application of the BaSAG and BRRD resolution regime to HETA has, however, not been undisputed. The most controversial issues are: (i) the principal applicability of the resolution measures under the BaSAG and the BRRD to HETA; and (ii) the unlimited guarantees for all HETA obligations assumed in the 1990s by the Austrian Province of Carinthia. Regarding these Carinthian unlimited guarantees, the Hypo Reorganization Act (HaaSanG), adopted in 2014, provided for certain categories of the guarantees to expire. However in July 2015, the Austrian Constitutional Court declared the HaaSanG unconstitutional, and it was repealed in its entirety. One of the reasons for this decision was that HaaSanG made a non-justifiable and non-proportionate distinction between the guarantees of junior creditors and other creditors. Furthermore, the Austrian Constitutional Court found that legal guarantee statements issued by a federal province cannot be rendered completely invalid retroactively through a single measure imposed by law. Earlier this year, *Bloomberg News* said of this still unresolved situation, "Austria has its own little Greece."

CONCLUSION

The author, David Christian Bauer, is involved in the case. DLA Piper lawyers in Vienna have advised extensively on highly complex legal issues arising in connection with the resolution of HETA. We await the next moves by the FMA and the creditors. Meanwhile, it is certain that the resolution of HETA in Austria will continue to set precedents which will determine the development of the European bank resolution regime.

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NEW RESTRUCTURING LAW IN POLAND HELPING BUSINESSES

The Polish parliament recently adopted a new law which will significantly change the country's insolvency regime and give businesses a second chance at survival – the Restructuring Law, Journal of Laws 2015 No 987.

OVERVIEW

The reasons underlying the adoption of the Restructuring Law were clearly highlighted by the Deputy Minister of Economy, who stated, "Difficulties are not a reason to shut down a business. The point is to change the business." The main goal of the new law is therefore: to introduce an effective mechanism for restructuring a debtor's business and preventing its liquidation.

> *"The reasons underlying the adoption of the Restructuring Law were clearly highlighted by the Deputy Minister of Economy, who stated, 'Difficulties are not a reason to shut down a business. The point is to change the business."*

The Restructuring Law introduces new legislation and also significantly amends the existing Bankruptcy and Recovery Law (Journal of Laws, 2003 No. 60 p. 535). The Restructuring Law makes a clear distinction between restructuring proceedings and bankruptcy proceedings. The Bankruptcy Law's current restructuring procedures are regarded as ineffective and value destructive or likely to lead to closure of the business and are therefore rarely used. In contrast, the new Restructuring Law is intended to allow for the restructuring of a debtor's undertaking whilst preventing its bankruptcy.

NEW WAYS OF RESTRUCTURING

Generally, the continuation of a business is more favorable to creditors – it preserves jobs and allows for the uninterrupted execution of contracts. The aim of the major amendments is to streamline "classic" bankruptcy proceedings, reduce unnecessary formalities, enable more effective restructuring and expedite liquidation proceedings. The Restructuring Law seeks to help enterprises avoid liquidation – but, if liquidation is inevitable, it will provide for liquidation proceedings that are faster and more efficient.

The Restructuring Law provides four new types of procedures aimed at restructuring distressed businesses and enabling arrangements (settlements) with creditors:

1. **Procedure for approval of plan after creditors' vote** – This procedure is available to debtors whose contested liabilities (the ones which are disputable between the debtor and a creditor) do not exceed 15 percent of their total debt. They must obtain (without court involvement) approvals for the arrangement terms from creditors. At least two-thirds of all creditors must vote in favour. A motion for restructuring is filed by a debtor only after the required majority's approval is obtained. Based on that, the court can only issue a decision on acceptance or rejection of the motion.

2. **Accelerated arrangement procedure** – This is a fast-track restructuring proceeding in which creditors deliver their votes directly to the court. The entire proceedings are intended to be fairly informal. This procedure is also designed for debtors whose contested liabilities do not exceed 15 percent of contested claims of the voting on the arrangement.

3. **Ordinary arrangement procedure** – This procedure is for debtors who are unable to meet the above criterion of 15 percent liabilities. An ordinary arrangement will be carried out under the current rules applicable to bankruptcy proceedings with the possibility of arrangement.

4. **Rehabilitation proceedings** – These proceedings will enable a deep economic restructuring of the debtor's assets and obligations. This seems to be designed to help enterprises at the very early stage of experiencing financial difficulties. Within this framework, it will be possible to adjust the employment level to the needs of the reorganised undertaking or to rescind disadvantageous reciprocal contracts.

Each of these proceedings is available both to insolvent enterprises and to those threatened by insolvency. These proceedings are intended to lead to an arrangement with creditors upon obtaining consent from the majority of them.

Companies in financial difficulty will be able to use these proceedings voluntarily. As a rule, each type of restructuring proceeding will be initiated by the debtor (subject to certain exceptions) with a view to concluding an arrangement with all creditors, once the consent of the required majority has been obtained.

THE DIGITAL RESTRUCTURING PROCEEDING

Perhaps the most significant aspect of the new Restructuring Law is the creation of an electronic Central Restructuring and Bankruptcy Register (CRRiU). The register will contain all of the decisions and rulings issued in the above-mentioned proceedings after the relevant creditors' vote as well as all of the decisions issued in any bankruptcy proceedings by the court. The CRRiU is designed to enable participants in proceedings to upload all required motions and documents. It is intended to operate not only as a communication and information tool, but also as a case law portal for companies dealing with restructuring.

This is a very important step for enterprises, not least because the CRRiU will make business relations during the restructuring process more transparent, stable and reliable. For instance, currently at the contract stage enterprises do not have any official tools to check the financial viability of their business partners. Unfortunately, it will be some time before businesses can enjoy the advantages that the CRRiU is expected to confer. Regulations relating to the creation of the CRRiU will not enter into force until 1 February 2018.

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CRIMINAL INSOLVENCIES ARE NOT A FAD

Spectacular crimes in connection with company insolvencies repeatedly shake up the German business world. "Criminal insolvencies" − insolvencies which were protracted and/or delayed by criminal acts which came to light only during the course of the insolvency proceedings − require the creditor's participation during insolvency proceedings. In addition, the creditor's advisors need to cooperate in an active and interdisciplinary manner in order to improve the creditor's position in the proceedings and to minimize their loss.

There are many examples of such criminal insolvencies over the past 20 years, among them the collapse of the real estate company of building tycoon Jürgen Schneider in 1994 and the insolvencies of FlowTex in 2000, Schieder Möbel in 2007, and S&K in 2012.

These cases also demonstrate that the criminal actions of perpetrators are not limited to actual insolvency crimes such as fraudulent bankruptcy (section 283 of the German Criminal Code (StGB)) and delayed filing for insolvency (section 15a of the German Insolvency Act (InsO)), but that general financial crimes are also committed to delay and hide insolvencies: in one instance, additional or increased loans were extended after the records relating to certain buildings constituting collateral for those loans were fraudulently altered so as to increase the letting space of such buildings so that these would appear to be of a higher value. In the case of FlowTex, not only was the balance sheet of the company significantly sugarcoated, but the purported multibillion-euro sales through which the company obtained multimillion-euro loans turned out to consist mostly of fictious transactions. The insolvency of Schieder Möbel shows a similar picture – balance sheet fraud, regular fraud, and credit fraud existed here, too.

THE ESUG AS AN ENABLER?

Despite the absence of concrete statistics, these cases confirm the suspicion that company structure may play a role in criminal insolvencies. Case law has shown that owner-led companies are more susceptible to criminal insolvencies: for certain owners, personal reputation and a view of the company as their main personal lifetime achievement may motivate them to commit insolvency- related and general financial crimes in order to conceal corporate failure.

The last few years have shown that the strengthening in 2012 of self-administration through the Law for the Further Facilitation of the Restructuring of Businesses (ESUG), the introduction of the protective shield proceedings and the related increase of self-administered insolvency proceedings have had the unintended effect of giving such perpetrators further tools to disguise criminal behavior upon insolvency. Requests for self-administered insolvency proceedings are increasing, particularly in larger and more complex company insolvencies. Since no independent third party, i.e. preliminary insolvency administrator is appointed to handle the insolvency proceedings, self-administration proceedings have *per se* the inconvenient consequence that previous criminal behavior of the management could further be covered-up to the detriment of creditors. In this context it must even be noted: no legislative basis exists for competent insolvency courts to post information online about the commencement of self-administered insolvency proceedings initiated as protective shield proceedings. In regular proceedings in Germany, either where a preliminary insolvency administrator is appointed or self-administration is approved this information is at least announced online, i.e. made public. In contrast, protective shield proceedings can even remain hidden completely from the public. As a consequence, for creditors there is no publicly accessible information source that would inform them about their business partners' financial status. This is particularly significant because it is initially up to the debtor to prepare a register of both creditors and assets based on which the proceedings will be continued.

ACTIVE PARTICIPATION OF CREDITORS IS REQUIRED DURING PROCEEDINGS

Creditors should become engaged as soon as self-administered insolvency proceedings commence. Many creditors mistakenly believe that the appointed trustee – equivalent to an insolvency administrator in regular proceedings – will protect their interests and pursue the best possible satisfaction of their claims. This is not necessarily the case.

Supervision and monitoring duties are imposed upon the trustee in self-administered insolvency proceedings; however, this does not compare to the nature and extent of the tasks and duties of an insolvency administrator in regular insolvency proceedings. In particular, the trustee neither "conducts" the proceedings nor any further business activity. In self-administration proceedings, these tasks fall upon the insolvent company itself.

In addition, in drafting the ESUG, legislators intended for the trustee to carry out the supervision of the self-administering debtor together with the creditor bodies and proceedings - the creditors' committee and the creditors' meeting. The cooperation of these bodies is therefore essential to creditors. Without being too critical of the company's management, creditors should query and examine the circumstances that led to the company's troubles. This process would increase the likelihood that criminal actions will be uncovered, making it more likely that criminal and civil law claims will be enforced.

Ideally, the full range of creditor rights should be deployed, including the right to ask questions, receive information and potentially seek a revocation of the self-administration order by the relevant insolvency court. In practice, however, few creditors actually make use of these rights, which is both surprising and regrettable, given that creditors have significant participation and control rights in self-administered insolvency proceedings, and legislators had intended for creditor's rights to be strengthened during preliminary proceedings.

If during the proceedings it becomes apparent that a criminal insolvency exists, the creditor's priority must be to secure all existing assets. If necessary, it may be possible to secure assets by taking civil-procedural measures early, such as attachments. Devising extensive compliance measures in respect of potential third parties which have been involved are also advisable here. It may be possible to also assert claims for damages against such third parties, such as tax advisors or certified public auditors, who may bear joint responsibility for, *inter alia*, delaying or disguising the insolvency.

INTERDISCIPLINARY COOPERATION OF ADVISORS

Early and close cooperation between insolvency, criminal, and civil or civil-procedural lawyers can expedite the process of identifying and dealing with criminal acts revealed during an insolvency. This certainly extends to cooperation with the certified public auditors and/or tax advisors who concentrate on forensic financial investigations, and whose participation may be invaluable for uncovering criminal acts.

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Furthermore, collaborating with the public prosecutors and civil courts is beneficial to creditors: as they will be delivering criminal complaints and preparing the often complex facts for the investigating authorities, in order to reduce the duration of the proceedings and obtain a quicker settlement of the remaining assets.

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IMPENDING MAJOR REFORM OF THE GERMAN INSOLVENCY CLAWBACK REGIME

A key objective of the current German coalition government is the reform of the clawback provisions in the German Insolvency Act (*Insolvenzordnung - InsO).* To address this, the German Federal Ministry of Justice and Consumer Protection recently published a draft bill for discussion. The German government is expected to remain in office until 2017, making it highly likely that this reform will become law, in the course of 2015-2016.

BACKGROUND AND OBJECTIVE OF THE REFORM

The principal aim of the reform is to offer a higher degree of predictability to economic transactions and to lower the risk of clawbacks. Existing German clawback provisions date to 1994 and have come under increasing criticism by both the German business community and German unions, in particular section 133, paragraph 1 InsO., which allows an insolvency administrator appointed to a company to contest transactions with that company for "willful disadvantage" (*Vorsatzanfechtung*) to the detriment of all of that company's creditors. This means that any transaction undertaken with the company during the ten years prior to its application for the opening of insolvency proceedings, or subsequent to such application entered into by the company, with the intention of disadvantaging its creditors upon its insolvency, can be contested if the creditor in such a transaction was aware of the company's intention on the date of the transaction. In addition, there has been criticism due to increased attempts by some insolvency administrators to challenge the payments of salaries to the company's employees.

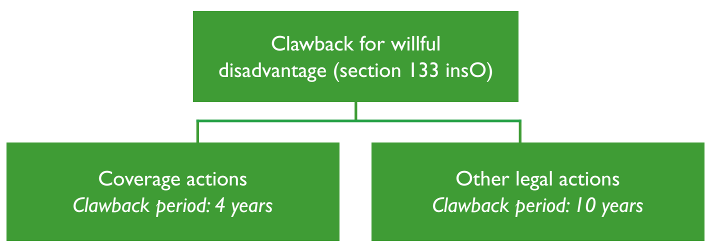
ENVISAGED LIMITATION OF CLAWBACK ACTIONS FOR WILLFUL DISADVANTAGE

According to the reform, the general provision for such clawbacks for willful disadvantage shall remain unaffected. However, the revised rules will make a distinction between so-called coverage actions, i.e. actions which provide security or satisfaction to a creditor, and other legal actions, such as the selling of assets under market value. The new rules will significantly shorten the clawback period for coverage actions in cases of willful disadvantage from ten to four years prior to the application for insolvency proceedings.

In addition, the draft bill makes a distinction between the congruent actions of granting of security or other rights in favour of a creditor who is contractually entitled to such security or rights, and the granting or facilitating of security or other rights in favour of a creditor who is not contractually entitled to such security or rights. Clawback actions in respect of coverage provided to the former class of creditor (i.e. pursuant to a contractual entitlement) shall only be admitted if the debtor who granted the coverage acted in the knowledge of its inability to pay its debts and the creditor was on notice of such inability.

For other cases of willful disadvantage, in particular the displacement of assets or bankruptcy actions, the existing provisions shall remain in place. This means that the clawback period of 10 years prior to the application for insolvency proceedings and the respective case law will still apply.

Hence, the reform would lead to the following system for clawback actions for willful disadvantage:



RE-SHIFTING THE BURDEN OF PROOF

Furthermore, the draft bill contains legal clarifications which intend to provide more predictability regarding the interpretation and practical application of the legislation. Crucially, this would reverse some longstanding case law of the Federal Court of Justice (*Bundesgerichtshof* - BGH), Germany's highest civil court, which had considerably shifted the burden of proof for the benefit of the insolvency administrator. This case law is now the subject of criticism and the BGH appears to be retreating from it.

The new reform aims to clarify several issues including the following:

- A simple request by the debtor for a customary easing of payment terms (*verkehrsübliche Zahlungserleichterung*) may by itself no longer count as evidence for the intent to willfully disadvantage the creditors.
- The same shall apply in the course of enforcement measures with regard to amicable settlement efforts that are reached between the debtor and the creditor via settlement negotiations conducted by the court's enforcement officers.
- Similarly, the new rules would also eliminate legal uncertainty with regard to clawback actions in cases in which the creditor supports restructuring measures of the debtor or in which equivalent transactions by which the market value of an asset is paid in a timely manner according to standard market practice shall ensure the continuation of the debtor's business.

SPECIFICATION OF THE PRIVILEGE FOR CASH TRANSACTIONS

According to the current section 142 InsO, payments by the debtor in return for which it benefited directly from a consideration of equal value are so-called "cash transactions" (*Bargeschäft),* and may only be challenged under the conditions of section 133 InsO (see above).

With regard to clawback actions regarding employee salaries, the reform clarifies that if the period between the performance of work by the employee and the employee's compensation for this work does not exceed three months, then such employee payment is regarded as a cash transaction and thus cannot be clawed back.

PRIVILEGED STATUS OF CREDITOR SATISFACTION THROUGH ENFORCEMENT MEASURES

According to the new law, coverage which has been achieved through enforcement measures on the basis of an enforcement resulting in title being obtained through court proceedings may only be challenged under the conditions of section 130 InsO, i.e. if the enforcing creditor knows about the debtor's inability to pay its debts. The respective changes to section 131 InsO are, in particular, intended to protect employees and small and mid-sized companies which have incurred procedural and cost risks in order to obtain a court order.

NEW RULES ON INTEREST RATES OF CLAWBACK CLAIMS

Section 143 InsO which deals with the legal consequences of clawbacks shall be amended with regard to the interest to be paid for clawback claims. In the future, clawback actions shall only bear interest according to the general rules on interest for default and section 291 of the German Civil Code (*Bürgerliches Gesetzbuch* - BGB). This new interest rule aims to eliminate wrong incentives for a slow enforcement of clawback claims and excessive interest charges. Until now, there was a perception in the market that insolvency administrators would be dragging their feet in prosecuting these clawback claims because the statutory interest rate under current market conditions is much higher than any market rate.

REACTIONS TO DATE

The German business community and German unions have welcomed the reform bill. As mentioned previously, the draft seems to have caused the highest German court to retreat from the current administrator-friendly case law. The German legal literature is varied on the reform: dogmatic supporters of general insolvency law principles are highly critical, whereas others welcome the idea of limiting clawback actions.

PRACTICAL CONSEQUENCES OF THE NEW REGIME

Despite the reform containing a number of positive changes, the German clawback regime will remain an uncertain area of German insolvency law for some time.

Although this reform would clearly lower the clawback risks in certain cases, unfortunately a high degree of unpredictability will remain as the new provisions contain numerous new terms which will need to be tested and clarified in court. This may take a decade or more, as with the current provisions that were enacted in 1994 and came into force in 1999.

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As a result, once this reform is enacted, those undertaking business in Germany will still need to seriously consider the clawback risks before entering into any significant transactions due to the potential financial ramifications.

Furthermore, businesses and their creditors should continue to operate with caution because the continuing unpredictability will result in insolvency administrators continuing to exploit this uncertainty in order to maximise the assets available to insolvency companies by seeking to obtain settlements with creditors.

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NULLIFICATION OF ANTI-ASSIGNMENT CLAUSES – GOOD NEWS FOR INVOICE FINANCERS AND THEIR CUSTOMERS

Currently, a clause in a contract which prevents one or both parties from assigning its rights under that contract is effective under English law. Such prohibitions on assignment are common in many types of contract. While this has not inhibited the growth of an active invoice finance market in the UK, it has necessitated waivers and workarounds (such as trust account arrangements) to allow the market to function.

WHAT'S CHANGING?

The UK Government proposes to make a change to the law so that a clause in an agreement which prohibits the assignment of a receivable will have no effect under English law. The nullification provision will only apply to the extent that the clause prohibits assignment of a receivable. A blanket prohibition on assigning any interest in the contract would therefore not prevent the assigning of a receivable, but would continue to prevent assignment of another right.

The government intends for the nullification provision to apply **to business to business contracts governed by English law where at least one of the parties carries on business in the UK.**

The nullification provision will not apply to:

- Financial services contracts (which is broadly defined but will include, among other things: lending contracts, guarantees, derivatives contracts, insurance contracts, and finance leases);
- Contracts relating to interests in land;
- Consumer contracts; and
- Contracts entered into before the regulations introducing the nullification provision come into force (i.e. the change will not apply retrospectively).

WHEN IS THIS HAPPENING?

The government has indicated that it intends to progress the regulations required to implement the change in Autumn 2015, with a view to the changes coming into effect in early 2016.

THE UPSIDES

For invoice financers, the main upside will be an increase in control. Following the change, it will be possible for invoice financers to take a legal assignment irrespective of any prohibition in the underlying contract. Assuming the new regulations do not interfere with the current position on resolution of disputes, invoice financers will therefore, if they choose to, be able to sue in their own right to recover the assigned debts without any need to involve the assignor.

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Small and medium sized business are, or at least were initially, the intended beneficiaries of the change. There was discussion of only extending the nullification provision to contracts with SMEs, but this has been rejected.

Currently, smaller businesses can find it difficult to access invoice financing, due to an unwillingness on the part of some invoice financers to take a risk using a workaround such as a trust arrangement where the customer may not have a strong financial position. The greater flexibility to use a legal assignment in all cases, may open up the invoice finance market to SMEs, and make them a more attractive customer base for invoice financers.

In addition, as debts will become freely assignable, this will assist the securitisation of receivables, releasing additional funding into the invoice finance sector.

THE DOWNSIDES

Concerns have been raised as to how the nullification provision will impact on the rights of debtors. Under the current law debtors can avoid any potentially adverse consequences of the invoices they owe being assigned by including an anti-assignment clause in their contracts.

During consultation, the government sought views on whether there should be provision to protect debtors from losses suffered due to the assignment. It appears, from the government's response to the consultation, that it does not intend to include such a provision in the new regulations.

There are also no plans to deal with set-off rights in the new regulations. Under the current law, an assignment could, after notice to the debtor, limit a debtor's right to set off amounts owing to it (for example, a liability owed by the supplier under a separate contract) against the debts owed to its supplier. While assignment could cause issues for debtors in this regard, contractual set-off terms may still preserve set-off rights post-assignment.

Debtors have also voiced concern about how disputes will be dealt with once the invoice is assigned. Who will the debtor deal with if an assigned invoice is disputed? The government has expressed its view that disputes in relation to invoices should continue to be dealt with between the debtor and the assignor even after the invoice had been assigned. It is unclear how the government proposes to proceed in this regard as its consultation response does not expressly cover this issue.

A slight downside for invoice financers and their customers is that, due to the retention of debtors' rights to sue the supplier for any breach of confidentiality restrictions which is made in the process of the assignment, they are unlikely to be able to ignore the terms of the underlying contract altogether. A due diligence exercise is still likely to be necessary, at least to check for confidentiality arrangements.

UNANSWERED QUESTIONS

There are still questions to be answered as to how exactly the nullification provision will operate. We await with interest the details which will be provided when regulations to implement the proposals are published.

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NOVEL USES FOR SCHEMES OF ARRANGEMENT – *AI SCHEME LIMITED* CASE STUDY

A scheme of arrangement is a statutory procedure under the Companies Act 2006 for effecting an arrangement between a company and its creditors (or any class of them) with the sanction of the court. Schemes can provide a solution where there is no complete consensus among stakeholders or where creditor composition creates a divergence of interests. Schemes are increasingly being used within the restructuring arena as a flexible financial structuring tool to deliver innovative pre-emptive turnaround measures and to prevent a course of action which might otherwise force a company (or group) to enter into an insolvency process which is destructive of value. Schemes are being used to effect a variety of restructurings and rehabilitations for financially distressed businesses, whether through a reorganisation of debt, equity or both.

OVERVIEW

In the past few years, the courts have approved changes to jurisdiction clauses in finance documents in order to give a matter "sufficient connection" to the English Court (*Apcoa*), approved changes to governing law clauses combined with centre of main interest shifts (*DTEK Finance B.V.*) and approved schemes restructuring a wider variety of obligations, such as those in Islamic finance documents (*Global Investment House KSC*).

This breadth and pace of change makes the scheme an attractive tool to those seeking to work around the strict terms of their financing arrangements. The scheme in *AI Scheme Limited [2015]* is no exception. In *AI Scheme Limited [2015]* we see the novel use of a special purpose vehicle created solely to enter into a scheme of arrangement to protect its parent company's financing arrangements.

IN THE MATTER OF *AI SCHEME LIMITED [2015]*

Affinion International Limited (AIL) is an English company which provides a credit card security product under several familiar brand names. It had three principal methods of selling its products: direct sales to its customers; sales with assistance of its business partners; and sales by its business partners (which include several mainstream banks) direct to customers.

The security product had several features, one of which was cover for loss occasioned by fraudulent use of a lost or stolen credit card. This element of the protection offered was probably not required, as customers were already protected under general consumer protection law or under the banks' Codes of Conduct. There was, accordingly, the potential for mis-selling claims to be brought by 1.991 million customers seeking redress; the average claim was estimated to be £180.

Given the potential scope of the claims, the company sought to put in place a simple, quick and effective redress procedure, and alighted on a scheme of arrangement. If AIL were itself to enter into a scheme of arrangement, it would pose a material risk of triggering an event of default under AIL's existing New York law-governed financing arrangements, thereby enabling an acceleration of AIL's debts, which would otherwise have been capable of being serviced as they fell due. Avoiding the stigma which attaches to an insolvency process was no doubt a consideration of AIL's directors in devising the structure of the scheme.

THE PROPOSED SCHEME

AIL settled on the establishment of a separate orphan scheme company, not owned by AIL or any of its partners (SchemeCo). SchemeCo was to be funded by AIL and its business partners paying an amount into SchemeCo to cover the redress to be paid to successful claimants, such payments to be made to SchemeCo on a "no liability" basis (i.e. payments made without an admission or acceptance of liability). SchemeCo also entered into a deed by which it assumed primary liability jointly and severally with AIL and its partners in respect of any claims brought by customers of the security product. It was then proposed that SchemeCo would enter into a scheme of arrangement under which redress would be provided to successful claimants and there would be a release by the scheme creditors of their direct claims against AIL and its partners, and a release of claims between AIL and its partners as between themselves.

THE COURT'S PERSPECTIVE

For the first time, the court addressed whether a special purpose vehicle could be created to enter into a scheme to avoid cross-defaults under the parent's financing arrangements. The court was unconcerned that SchemeCo was a deliberately created scheme company. Rather than seeing SchemeCo as a "*mere artifice*", the court instead held that both its creation and use to effect the scheme had "*solid grounding in commercial necessity*".

The court noted that SchemeCo would voluntarily assume liability alongside AIL and its partners to promote the scheme, and that there was sound commercial justification for it doing so. The proposed scheme deals with the contribution claims through a simple release. In short, receipt of compensation was predicated on the customers' release of SchemeCo, AIL and its business partners from any liability in respect of the customers' claims under the scheme. Similarly, internal warranty and indemnity cross-claims between AIL and its partners could also be dealt with through releases. The court held that the releases were part and parcel of an overall scheme to enable an efficient and economic disposal of claims, and were, in the court's view, an inherent part of the scheme. While releases of persons not party to the proposed scheme of arrangement is not a new point, it is additional confirmation of the decision in *Re La Seda [2010]* that a release of a third party's rights can properly form part of scheme proposals. It is also a further illustration of the flexibility of the scheme regime.

The court also drew attention to the nature of the proposed scheme creditors. They would be customers, each with a relatively small monetary claim and none of whom would have sufficient access to advice in relation to the complex issues arising in the case. The complexity would have rested in bringing complementary claims in contract and in tort, and having such claims against both AIL and the seller/facilitator of the product.

PRACTICAL ADVICE

On the whole, the court found that the proposed scheme was a sensible mechanism for dealing with multiple small claims efficiently and economically. The scheme provided a mechanism for redress which had less stringent requirements to be satisfied than if the claimants were to pursue their claims at law or through the regulatory authorities. Indeed, in its communications to potential claimants, AIL confirmed that each potential claimant "*will receive exactly the same amount of compensation as you would have done had [AIL] promoted the scheme*".

"On the whole, the court found that the proposed scheme was a sensible mechanism for dealing with multiple small claims efficiently and economically."

It is of note that not all purchasers of the security product were covered by the proposed scheme. Among others, customers who dealt with AIL before the company became regulated by the Financial Conduct Authority and those with a *de minimis* claim of £5 or less were excluded from the scheme. It is therefore clear that a scheme does not need to include all creditors; it is a matter for the company to identify those creditors with whom it wishes to enter into an arrangement, provided of course that the selection is not arbitrary and there is commercial justification for the selection. Such excluded creditors were not however debarred from making a claim; they continued to retain their existing claims which could be pursued according to conventional means outside the scheme.

It remains clear that schemes are flexible tools which ensure sensible rearrangement of rights and that provided a proposed scheme falls within "an arrangement" for the purposes of the statute and the structure is sensible and appropriate, the courts remain open to it.

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"NO TRUST WITHOUT INTENTION" – THE IMPORTANCE OF CERTAINTY IN MANAGED INVESTMENT SCHEMES

The Australian High Court has refused to impute the intention to create a trust "simply for the purpose of protecting or creating a commercial interest". The decision serves as a reminder that a trust is an institution requiring absolute certainty and intention, and not a remedy to be found by the courts.

OVERVIEW

In March 2015, the Australian High Court overturned a decision of the Victorian Supreme Court, refusing to find that proceeds from the sale of timber and plantation land were held on an express trust in favour of investors in an agricultural managed investment scheme (MIS) managed by companies in the Gunns Group.

The decision could have significant ramifications for foreign investment in agricultural assets in Australia and could even operate as a barrier to entry. The failure of the Gunns MIS and others has sparked debate on the efficacy and success of the MIS approach in protecting foreign investors' proprietary rights in the forestry industry.

BACKGROUND

The Gunns Group was a large forestry business operating out of Tasmania, Australia. Its operations included forest management, wood-chipping, sawmilling and veneer production. The group collapsed in 2012 and external administrators were appointed. Investors in the Gunns group did not have registered security over the timber or the land but sought to claim the proceeds of sale from the external administrators on the basis that the timber and land (and the proceeds from their sale) were held on an express trust for them and not available for distribution to other creditors.

Company One entered into a Trust Deed with Australian Executor Trustees (AET) pursuant to which the AET would act as trustee for investors in the companies. Furthermore, a tripartite deed was entered into between the two companies and AET pursuant to which Company Two would pay proceeds from timber sales to Company One, which would then pay the remainder to the AET to distribute among investors. While there was an undisputed trust between the AET and the investors, the question for the court was whether the companies also owed trustee duties to the investors.

DECISION

The court held that there was insufficient evidence of express intention to create a trust between the two companies and the investors; the relationship was merely contractual. As a result of this holding, approximately AU$87 million became available to creditors of the Gunns Group and not its investors.

IMPACT ON FORESTRY INDUSTRY AND FOREIGN INVESTORS

The collapse of the Gunns group and others using a similar MIS, along with market challenges, the transition of the forestry industry to institutional ownership and the uncertainty surrounding the rights of investors – particularly foreign investors – is a significant concern in the agricultural sector. Foreign investment is low in Australia, at just 3.4 percent as of March 2014. In contrast foreign investment in Hong Kong is at 60 percent and in Singapore is at 80 percent. The 2014 Murray Financial System Inquiry (the FIS report) found that barriers to foreign investment remain and that Australia's trust law will require greater codification if it aims to promote international investors' understanding of Australia's regulatory framework.

"The collapse of the Gunns group and others using a similar MIS, along with market challenges, the transition of the forestry industry to institutional ownership and the uncertainty surrounding the rights of investors – particularly foreign investors – is a significant concern in the agricultural sector."

Various inquiries into agricultural MIS are focusing on the interests of investors. The Australian Senate Economics References Committee is examining the structure of forestry MIS, including compensation arrangements for small investors and options for reforming forestry MIS to protect investors. Similarly, the FIS report questioned the adequacy of the current regulatory framework and whether it sufficiently safeguards the rights of investors, "especially compared with companies".

CONCLUSION

The court's decision sends a message to companies: re-evaluate managed investment schemes to ensure that you are providing absolute certainty and intention when you intend to create proprietary rights and a trust. The courts will not find trusts retrospectively at your convenience.

Secured creditors can take some comfort from the decision insofar as it reduces the likelihood of their claims to assets in insolvency being defeated by the finding of an imputed trust.

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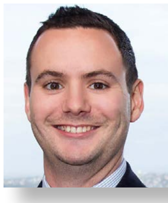

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THE REVISED EC REGULATION ON INSOLVENCY PROCEEDINGS SEEKS TO RESOLVE PRACTICAL CONCERNS

The European Council Regulation No 1346/2000 on insolvency proceedings (the Regulation) was adopted in May 2000 and came into force on 31 May 2002 in order to establish a European framework for cross-border insolvency proceedings. The Regulation regulates: the jurisdiction for opening insolvency proceedings; recognition and enforcement of judgments for the opening of insolvency proceedings; the laws applicable to insolvency proceedings and their scope of applicability; and cooperation in a cross-border insolvency context.

Following on from the Q3 2014 edition of *Global Insight* in which we discussed the proposed amendments to the EC Insolvency Regulation, we can now provide details of the ensuing Regulation (EU) 2015/848 - the New Regulation, enacted on 20 May 2015.

In 2012, ten years after the Regulation's enactment, the European Commission reviewed and published a proposal for its amendment, aiming to provide more practical, rescue-orientated solutions for financially distressed debtors.

The New Regulation addresses the following concerns:

- **The narrow scope of the insolvency proceedings covered by the Regulation will be extended** to cover (i) pre-insolvency proceedings which are aimed at the restructuring of a debtor in financial difficulties at a pre-insolvency stage and (ii) hybrid proceedings aimed at a collective restructuring of debts but where the existing management is left in place. Despite this extension in scope, however, only proceedings which are listed in Annex A to the New Regulation will be covered, which means that Member States will retain significant control over the category of proceedings to be encompassed by the New Regulation.
- According to Article 3 (1) of the Regulation, **the courts of the Member States within the territory of which the centre of a debtor's main interests (COMI) is situated shall have jurisdiction to open insolvency proceedings**. In this context, the following concerns were raised: (i) absence of a general definition of COMI in the Regulation; (ii) cases of evident and abusive forum shopping; (iii) uncertainty surrounding the relevant time at which a debtor's COMI should be determined; and (iv)the absence of assessment of jurisdiction by national courts.
- The New Regulation aims to resolve these issues with the following provisions: (i) a statutory definition of COMI is introduced which, in line with European case law, provides that COMI shall be the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties; (ii) there is a specification that a debtor's COMI should be determined when the request for the opening of insolvency proceedings is made; and (iii) by the combination of certain presumptions as to relocation of registered office or principal place of business, the New Regulation seeks to establish safeguards against "bankruptcy tourism". Further changes include (iv) a requirement for courts presented with a request to open insolvency proceedings to examine whether they have jurisdiction and not to take it for granted *per se*; and (v) a right for debtors and creditors to challenge the decision to open main insolvency proceedings on the grounds of international jurisdiction.
- The New Regulation **seeks to establish a system for inter-connecting national registers** and to provide access to it through the European E-Justice Portal. The system is already available to perform searches in respect of proceedings commenced in the Czech Republic, the Netherlands, Austria, Germany, Estonia and Slovenia.

CROSS-BORDER

- Significant amendments have been made by the New Regulation to the provision relating to **secondary proceedings**. Originally, the aim of secondary proceedings was to offer a tool for liquidators in main proceedings where the estate of the debtor was too difficult to administer as a unit or where differences in legal proceedings between jurisdictions were quite extensive. In practice, however, secondary proceedings were often used for other reasons, and the New Regulation seeks to surmount these issues by providing for the following new provisions: (i) it has removed the requirement which limited secondary proceedings to winding-up proceedings; and (ii) it requires notice of a request to open secondary proceedings to be given to practitioners or to the debtor in possession in the main proceedings, who will then be given an opportunity to be heard on the request. Finally, (iii) the duties of cooperation are expanded to include not only cooperation between insolvency practitioners but also between courts in different jurisdictions and between insolvency practitioners and the courts.

- The most note-worthy amendment included in the New Regulation, is a set of entirely new provisions aimed to facilitate the better coordination of cross-border group insolvency. Most significant enterprises now operate via a network of connected subsidiaries, often registered and with their COMIs in different jurisdictions. The New Regulation introduces the concept of "group coordination proceedings" where an independent practitioner can be appointed to develop a plan which will facilitate the better preservation of value of the insolvent debtors' assets. Participation in the coordination and implementation of the plan (which may propose integrated steps to resolve intra-group disputes and to develop a group restructuring plan) is optional: group members are entitled to opt out at any time.

"The New Regulation introduces the concept of 'group coordination proceedings' where an independent practitioner can be appointed to develop a plan which will facilitate the better preservation of value of the insolvent debtors' assets."

ANALYSIS

The modifications reflect a wide-held desire to ensure that insolvency legislation facilitates the early restructuring of viable companies in financial difficulty and provides entrepreneurs with a second chance. The majority of the provisions of the New Regulation (except for the establishment of integrated registers for which a further year has been allowed) will apply to insolvency proceedings commenced after 26 June 2017.

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NEWS ROUNDUP - Q3 2015 (ISSUE 15)

PARTNER INTEROFFICE MOVE

French Restructuring partner **Noam Ankri** has transferred from the Paris to the London office. Noam, who has previously worked in New York, has a strong international funds-based practice, including private equity, distressed M&A, and in-court/out-of-court debt restructurings. Noam was recently named as a rising star for Insolvency & Restructuring in the Legal Media Group's 2015 Rising Stars Guide.

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AWARDS

- UK: DLA Piper has been shortlisted in the 'International Firm of the Year' and 'Insolvency Law Firm - 8 or more office locations' categories at the 2015 Insolvency & Rescue Awards.

- Europe: DLA Piper has been awarded 'Best *Diversity Initiative in an International Firm'* for the Leadership Alliance for Women (LAW) programme at the 2015 IFLR European Women in Business Awards.

- The US was the third consecutive year, *Working Mother* magazine has named DLA Piper as one of the 50 best law firms for women, recognising the firm's steady commitment and progress toward greater workplace equality. This is in addition to the Women in Law Empowerment Forum (WILEF) giving the firm Gold Standard Certification for the fourth consecutive year.

- Scotland: DLA Piper has been awarded 'Law Firm of the Year' at the prestigious Law Awards of Scotland 2015. This follows on from DLA Piper's previous recent success at the Scottish Legal Awards 2015 where it won 'Firm of the Year' and also received the Pro Bono Award.

- Ukraine, Poland: DLA Piper was awarded 'Best in Country awards' for Ukraine and Poland at the 2015 IFLR European Women in Business Awards on 18 June 2015.

- Australia: DLA Piper has been named as a finalist in the Lawyers Weekly Australian Law Awards 2015 in the categories of Law Firm of the Year, Employee Program of the Year, Government Team of the Year, Young Gun of the Year - **Elliott Cheung** (Sydney).

- The US Restructuring Group was ranked nationally in Tier 1 for Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law by Best Lawyers. Best Lawyers recognized 16 DLA Piper lawyers as "Lawyer of the Year" within their practice and geographic areas. Only a single lawyer in each practice area in each community was honored as "Lawyer of the Year." Congratulations to **Mark Friedman** (Baltimore) for being recognised. Many of our lawyers are included in the "Best Lawyers in America" list, including: **Stuart Brown** (Wilmington), **Thomas Califano** (New York), **Mark Friedmann** (Baltimore), **Gregg Galardi** (New York), **Eric Goldberg** (Los Angeles), **Richard Kremen** (Baltimore), **Craig Rasile** (Miami) and **Alan Solow** (Chicago).

NEWS

DLA Piper (Canada) LLP continues to rank highly in the 2016 edition of Best Lawyers in Canada, with the highest number of firm lawyers recognized to date. In total, 64 lawyers across 34 practice areas are celebrated in the guide for their excellence and leadership.

NEWS ROUNDUP

EVENTS

Recent

- 6-8 August - **Stuart Brown** (Wilmington) was a member of the panel "Keeping Up with the Supremes: Supreme Court Update" at ABI's Annual Mid-Atlantic Bankruptcy Workshop held in Hershey, Pennsylvania
- 8 September - WIN Future Legal Leaders: Impact without Authority
- 10 September - WIN: Human Rights workshop
- 17 September - WIN Legal Professional Privilege: An International Perspective
- 23 September - **Craig V. Rasile** (Miami) was a panelist at the EB-5 Seminar hosted by the City of Miami, in which he discussed financially distressed EB-5 real estate projects
- 24 September - WIN Pro Bono Training: Tendering for Government Contracts
- 24 September - WIN Keynote Panel: Cybersecurity

Upcoming

- 30 September Future of the City Dinner with Dame Colette Bowe, Chairman, Banking Standards Review Council
- 12-13 October - DLA Piper is sponsoring the INSOL Africa Roundtable in Cape Town, South Africa. **Richard Chesley** (Chicago) will be a speaker in the "The Importance of Practitioner Standards and Skills in Restructurings and Liquidations" session on 13 October
- 15 October - Spectator Breakfast Debate: "What impact will the Chinese downturn have on the UK?"
- 15 October - WIN Future Legal Leaders: Communication skills webinar
- 21 October - International Data Protection and Data Privacy Webinar
- 19 November - WIN Future Legal Leaders: Negotiation skills webinar
- 31 November - WIN Finance for Lawyers
- 1 December - WIN Pro Bono Training: Charities and the Bribery Act

If you are interested in attending any of the above events please contact restructuring@dlapiper.com.

To register for and find out more about our WIN: What In House Lawyers Need events please visit http://www.dlapiperwin.com/.

GLOBAL RESTRUCTURING GROUP

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Our Global Restructuring group is one of the largest in the world, with over 200 dedicated restructuring lawyers across the Americas, Asia Pacific, Europe and the Middle East. We have the knowledge, experience and resources to address our clients' restructuring and insolvency needs on a national and international basis.

We serve a diverse client base encompassing debtors, lenders, government entities, trustees, shareholders, directors, and distressed debt and asset buyers and investors. We advise clients across a wide range of industry sectors and have particular strength in energy, financial services, health care, hospitality and leisure, real estate, retail, sports, technology and transportation.

ADEPT AT ALL LEVELS OF COMPLEXITY

We advise on all matters relating to public and private companies in underperforming and distressed situations. We manage assignments from the mid-market to the largest national and international restructurings and insolvencies. Our experience also extends to any contentious issues arising from restructurings and insolvencies. We have significant experience of advising clients on, investigation, enforcement, litigation and asset recovery on a multijurisdictional basis.

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With our global team of dedicated restructuring lawyers we have detailed knowledge of local markets and the associated challenges our clients face. We are passionate about what we do and our clients see this in the quality of work our lawyers provide. Our Global Restructuring group is part of one of the world's largest law firms with 4,200 lawyers located in more than 30 countries. As a full-service business law firm, we offer clients the benefit of the collective knowledge and experience of all our practice groups.

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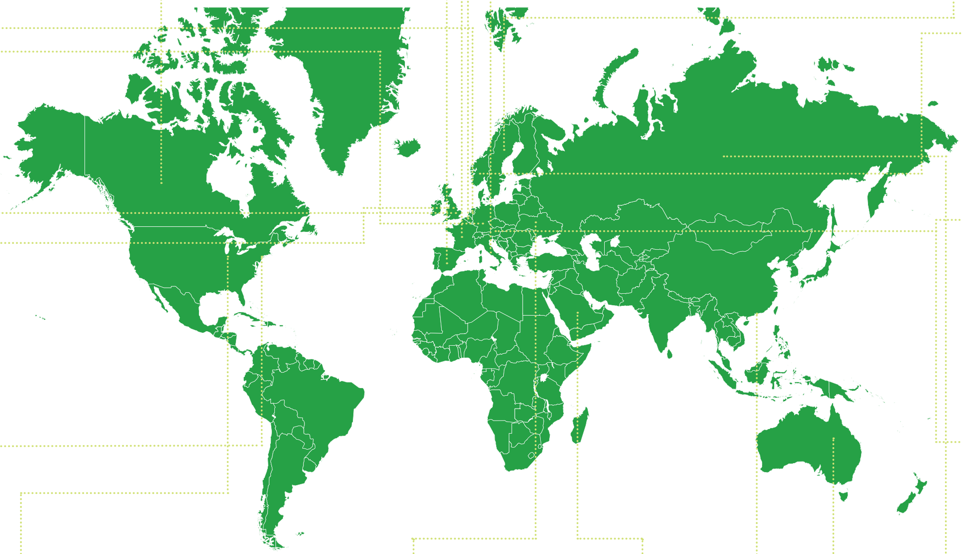


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