Debt Restructuring in Transition

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I. Introduction

UK debt restructuring is undergoing a period of immense change. Two developments in particular have contributed to this transformation. The first is legislative: the Corporate Insolvency and Governance Act 2020 (CIGA) introduced powerful new tools into the armoury of financially distressed companies wishing to restructure their debt. The second is political: the UK's exit from the EU has impacted on UK debt restructuring, particularly the use of English restructuring tools involving companies with creditors in EU member states. These developments have profound implications for the UK debt restructuring regime and for UK insolvency law more broadly.

While the effects of Brexit on debt restructuring were an unintended side-effect of that process, the introduction of new restructuring tools via CIGA were intended to reshape the UK debt restructuring landscape. There were three drivers of these legislative changes. The first was a desire to respond to perceived weaknesses in the existing regime. This is not to suggest that prior to CIGA the UK debt restructuring regime was unsuccessful. On the contrary, UK practitioners and courts developed powerful debt restructuring tools to deal with financially distressed companies.[1] In particular they utilised the scheme of arrangement[2] either as a standalone device, or in combination with other mechanisms,[3] and these have become an effective tool for restructuring not only the debt of UK companies, but also overseas companies that sought to make use of the English court's jurisdiction.[4] However, existing UK debt restructuring mechanisms lacked certain elements, including a cross-class cramdown mechanism whereby a restructuring can be imposed on one or more classes of dissenting creditors, and a statutory stay to prevent creditors enforcing their debt or utilising other legal protections during the restructuring.[5]

The second driver was regulatory competition. There has been an increase in political focus on rescuing companies in the UK and elsewhere, in part as a result of the World Bank Doing Business figures.[6] Furthermore after a period of dominance for the UK as a debt restructuring centre, recent

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[1] A distinction can be drawn between financially distressed companies where there is a business that is worth saving and a company whose business model is fundamentally flawed (referred to as economic distress): D. G. Baird, "Bankruptcy's Uncontested Axioms" (1998) 108 Yale L.J. 573.

[2] See Companies Act 2006, Part 26.

[3] E.g. *Re Bluebrook Ltd* [2009] EWHC 2114 (Ch); [2010] B.C.C. 209.

[4] E.g. *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch); [2012] B.C.C. 459.

[5] Insolvency Service, *A Review of the Corporate Insolvency Framework: A Consultation on Options for Reform*, May 2016; BEIS, *Insolvency and Corporate Governance: Government Response*, 26 August 2018 and see S. Frisby, 'Of rights and rescue: a curious confluence' [2020] J.C.L.S. 39Although in theory it is possible to use administration to create moratorium protection in a debt restructuring, this is rarely done.

[6] See e.g. World Bank Group, *Doing Business 2020: Comparing Business Regulation in 190 Economies.* There have, however, been difficulties with the World Bank Doing Business project. After data irregularities on Doing Business 2018 and 2020 were reported, in June 2020, World Bank management paused the next Doing Business report and initiated a series of reviews and audits of the report and its methodology.

years have seen the introduction of rival regimes such as the reformed Singaporean debt restructuring regime,[7] the Dutch scheme of arrangement,[8] and a number of other regimes introduced following the EU Restructuring Directive.[9] These mechanisms include tools, such as the opportunity for cross-class cramdown and access to a moratorium, which the UK regime lacked. These regulatory competition concerns were exacerbated by the UK's departure from the EU, accompanied by a political will to ensure that the UK remains at the forefront of these issues internationally.

The third driver was the Covid-19 pandemic, or rather the financial distress that this pandemic precipitated in companies around the country. Many of these were viable businesses which suddenly faced an acute liquidity crisis as a result of the pandemic. For such companies debt restructuring can offer significant advantages over the alternatives. Liquidation can lead to the destruction of some or all of the going concern value of the business, while a sale to a third party in an auction process will not always be possible or desirable, especially in times of financial crisis where markets are illiquid.[10] In the circumstances, it made sense for the Government to dust off the Insolvency Service's reform recommendations for new and more powerful debtor-friendly tools designed to facilitate the rescue of financially distressed companies.[11] As a result CIGA introduced a new bespoke debt restructuring device, the restructuring plan, a new standalone restructuring moratorium and broad constraints on the use of clauses that would allow a counterparty to terminate a contract or accelerate payment on the grounds of insolvency alone (*ipso facto* clauses).

These developments, CIGA plus Brexit, have four major implications for UK debt restructuring, which are examined in this article. These are: a shift from a creditor-focused regime to one which is more pro-debtor; the development of a modular system for debt restructuring, and insolvency more generally; a blurring of the boundary between restructuring and insolvency; and a more complex cross-border regime. In combination these amount to a potentially seismic shift in the UK debt restructuring landscape. They have profound implications not just for the companies themselves, their creditors, their employees, customers and other stakeholders, but also for the economy more generally. There are also significant political implications for the UK's role as a global player.

The full consequences of these seismic changes remain to be seen, however, as we are currently in a period of transition. The impact of these developments on creditor and debtor behaviour will only emerge over time, as commercial parties negotiate new arrangements, or renegotiate existing ones. Commercial parties are adept at accommodating changes to the law, but in this instance they are likely to be hampered by two factors. First, the precise parameters of these legislative changes will take some time to emerge as many of the details have been left to the courts to determine; it will take time for cases to come to court and for the jurisprudence on these issues to develop. Second, regulatory

[7] Singapore Insolvency, Restructuring and Dissolution Act 2018, ss. 64-66.

[8] Dutch Act on the Confirmation of Extrajudicial Restructuring Plans (Wet Homologatie Onderhands Akkoord).

[9] EU Restructuring Directive 1023/2019. For example, in Germany see Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen or StaRUG.

[10] See, e.g., A. Shleifer and R. Vishny, "Liquidation Values and Debt Capacity: A Market Equilibrium Approach" (1992) 42 J. Fin. 1343. There may also be other reasons why a sale will not be possible, such as where the transfer of crucial assets to a new entity is not feasible. Outside these scenarios, sales can have some advantages over restructurings as they avoid the need for potentially costly bargaining between the company and its stakeholders.

[11] The changes introduced by CIGA are not identical to the reforms suggested by the Insolvency Service. This is discussed further in part III.1.

competition has an important part to play in the choices that debtors and creditors will make and some of the potential competitors to UK debt restructuring mechanisms are also in the process of development, so that the strengths and weaknesses of these alternative procedures will only emerge over time.

After examining the impact of CIGA and Brexit on debt restructuring in part II, the four implications of these changes are analysed in parts III-IV. Together these create considerable commercial uncertainty for debtors and creditors. Understanding the implications of these changes is vital if this transitional period is to be navigated effectively. It will also be important to keep clearly in mind the core function of restructuring as a tool for resolving financial distress, in order to ensure that the new regime operates in a way which is beneficial to commercial parties and the economy more generally.

II. Recent developments in UK debt restructuring

Two developments are discussed in this section, namely the changes to debt restructuring introduced in CIGA and the effect of Brexit on this issue.

1. Corporate Insolvency and Governance Act 2020 (CIGA)

CIGA introduced a number of changes designed to combat the economic consequences of the Covid-19 pandemic, some temporary and some permanent. Of the latter changes the most significant for current purposes are the introduction of the restructuring plan,[12] a new freestanding restructuring moratorium, and broad constraints on *ipso facto* clauses.

The purpose of these changes is to provide debtors with more powerful tools with which to resolve their financial difficulties. At its heart, debt restructuring involves creditors who wish to remain invested in the company. It is a means of facilitating a new bargain between the existing creditors as to their future relationship, in contrast to insolvency procedures which reallocate the capital of a financially distressed company once the financial creditors have decided they no longer wish to be invested in it. The fundamental concern for restructuring is to prevent individual creditors frustrating the wishes of the majority in reaching this new bargain, often termed an anticommons problem.[13] Restructuring mechanisms therefore commonly involve constraints on individual creditor rights in order to maximise the chance that agreement can be reached. The ability to impose a restructuring on dissenting creditors falls squarely into this category and the introduction of the cross-class cramdown in the restructuring plan is designed to address this issue. By contrast the other two tools, the restructuring moratorium and the constraints on *ipso facto* clauses, address a different issue, namely a common pool problem whereby individual creditors may seize assets that are useful or perhaps essential for the carrying on of the debtor's business.[14] This problem is more commonly associated with insolvency rather than restructuring. After all, insolvency is a debt collection exercise designed to realise assets via a sale to a third party or as part of a piecemeal process and then distribute them to the creditors in accordance with their priorities. Insolvency is first and foremost a

[12] CIGA, s. 7 and Sch. 9, introducing a new Part 26A Companies Act 2006.

[13] See D. Baird and R. Rasmussen, "Anti-bankruptcy" (2010) 119 Yale L.J. 648; R. de Weijs, "Harmonisation of European insolvency law and the need to tackle two common problems: common pool and anticommons" (2021) 21 I.I.R. 67.

[14] See T.H. Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge MA: Harvard University Press, 1986).

collective procedure, designed to prevent individual creditors seizing assets of the company. This stands in contrast to restructurings which often involve a subset of creditors and involve no such sale and distribution. Furthermore, a restructuring uses future assets or income to overcome the debtor's financial difficulties, which are clearly not part of the common pool. Nevertheless, these new restructuring tools borrow some elements from insolvency law, which has implications for the UK debt restructuring regime as discussed later in this article.

i) Restructuring plans

A restructuring plan is a new mechanism but is based to a large extent on the pre-existing scheme of arrangement; at its heart it is a scheme of arrangement with the option of a cross-class cramdown.[15] One of the benefits of a restructuring mechanism created by the law (as opposed to a contractual workout) is the ability to impose it on dissenting creditors. The extent of the ability to interfere with creditor rights in this way varies from mechanism to mechanism. Some, such as Company Voluntary Arrangements (CVAs), merely enable the restructuring to be imposed on the minority of unsecured creditors.[16] Others, such as schemes of arrangement, enable the restructuring to be imposed on minority secured creditors too. Of course, interfering with creditor rights in this way requires some form of minority protection to be built into the mechanism. Schemes of arrangement involve the creditors (and shareholders where relevant) being divided into classes[17] and each class voting on the scheme. The court can only sanction the scheme of arrangement if all classes approve it,[18] so the scheme can go ahead despite the objection of the minority within a class but not if a whole class dissents. A scheme of arrangement alone cannot therefore facilitate a cross-class cramdown, whereby the restructuring is imposed on one or more classes. This stands in contrast to mechanisms elsewhere in the world, such as US Chapter 11,[19] the Singaporean scheme of arrangement,[20] and the Dutch restructuring plan.[21] In the UK a *de facto* cross-class cramdown[22] is possible if a scheme of arrangement is combined with administration. This has downsides, not least the need to utilise two mechanisms and the need to transfer the assets to a newco, raising tax issues as well as potential problems if intercreditor agreements make such transfers difficult or costly.

The introduction of the restructuring plan is intended to address this issue. Like a scheme of arrangement it is a debtor-in-possession mechanism with substantial court oversight. There are some

[15] This closeness is emphasised by the joint Practice Statement governing schemes and restructuring plans: Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006), 26 June 2020.
[16] Insolvency Act 1986, ss. 1-7.
[17] See *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241; [2002] B.C.C. 300.
[18] Companies Act 2006, s. 899(1).
[19] 11 U.S.C. §1129(b).
[20] Singapore Insolvency, Restructuring and Dissolution Act 2018, s. 70.
[21] Dutch Act on the Confirmation of Extrajudicial Restructuring Plans (Wet Homologatie Onderhands Akkoord) which entered into force on 1 January 2021.
[22] The cross-class cramdown is *de facto* rather than *de jure* because the dissenting creditors are left out of the scheme, so that they don't get the opportunity to vote against it. See *Re MyTravel Group Plc* [2004] EWCA Civ 1734; [2005] 2 B.C.L.C. 123; *Re Bluebrook Ltd* [2009] EWHC 2114 (Ch).

differences, however,[23] one important one being that, unlike schemes of arrangement that can be utilised whatever the debtors' financial circumstances, those seeking to utilise a restructuring plan face a financial threshold condition. Restructuring plans can only operate where the company has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern.[24] Furthermore, the purpose of the proposed compromise or arrangement must be to eliminate, reduce, prevent, or mitigate the effects of, any of the company's financial difficulties.[25] The other significant difference is the inclusion of the potential for a cross-class cramdown option. In common with schemes of arrangement, the minority protection within the restructuring plan exists in the form of the division of creditors/shareholders into classes and the oversight of the court. However, in recognition of the increased dangers to minority rights posed by the cross-class cramdown, additional minority protection is put in place.[26] Two conditions are provided for a cross-class cramdown to occur.[27] First, the court must be satisfied that, if the restructuring plan were to be sanctioned, none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative.[28] The "relevant alternative" for these purposes is "whatever the court considers would be most likely to occur in relation to the company" if the restructuring is not sanctioned.[29] Second, the compromise or arrangement must have been accepted at a class meeting of at least one class of creditors/members who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative.[30]

ii) Restructuring moratorium

The second significant innovation of CIGA is the introduction of a restructuring moratorium. Left to their own devices minority creditors can derail a debt restructuring not only by withholding their agreement (where unanimity is required) but also by exercising their rights either to enforce their debt or by initiating insolvency proceedings or other legal process. A moratorium is designed to address these latter possibilities; it is a legal intervention designed to promote the rescue of a company or business by enabling the debtor to keep operating as a going concern during this period. The intention is to provide a breathing space for the debtor within which it can reach agreement with its creditors and to enable the business to be kept together long enough for a reorganisation to be effected.[31] It has become common for jurisdictions to include broad moratorium provisions within

[23] For example, a different requirement the majority test required in the class meetings. A restructuring plan requires a simple 75% majority in value (Companies Act 2006, s. 901F(1)) whereas for schemes a headcount test is also required (s. 899(1)).

[24] Companies Act 2006, s. 901A(2). This threshold financial condition has been interpreted broadly: *Re Deep Ocean 1 UK Ltd* [2021] EWHC 138 (Ch); [2021] B.C.C. 483.

[25] Section 901A(3)(b).

[26] The Explanatory notes accompanying CIGA specify that in addition to the other requirements set out in the Act the court has discretion to decline to sanction a plan if it is not "just and equitable": BEIS, Explanatory Notes accompanying the Corporate Insolvency and Governance Act 2020, para. 190.

[27] Companies Act 2006, s. 901G.

[28] Section 901G(3).

[29] Section 901G(4).

[30] Section 901G(5).

[31] T. Jackson, "Bankruptcy, Non-bankruptcy entitlements and the Creditors' bargain" (1982) 91 Yale L.J. 857.

their debt restructuring regimes.[32] Until 2020 no statutory moratorium attached to schemes of arrangement.[33] Debtors wishing to protect themselves during the period that a restructuring was negotiated and implemented therefore sought various alternatives, the most common being to utilise a contractual standstill arrangement, whereby the creditors voluntarily commit to refrain from exercising their contractual rights.[34] This can work well where small homogenous groups of creditors are involved in the restructuring. [35]

The restructuring moratorium introduced by CIGA is standalone; it can be used in conjunction with restructuring mechanisms such as schemes of arrangement or restructuring plans, but it need not.[36] In contrast to the moratorium that attaches to administration, the restructuring moratorium is debtor-in-possession and allows directors to continue to run a company, subject to the appointment of a licensed insolvency practitioner (the monitor) and certain other restrictions. There is an in-court and out-of-court procedure for obtaining a moratorium. The out-of-court process will usually only be available to a company if it is not subject to an outstanding winding up petition and is not an overseas company.[37] It involves directors filing relevant documents at court and is similar to the current process for appointing administrators out of court, but unlike the administration process no prior notice need be given to floating charge holders before directors file for a moratorium. The effect of the moratorium is to impose a constraint on creditors' ability to assert their debt claims against the company and a constraint on initiating insolvency proceedings and other legal processes.[38] A company subject to a moratorium will obtain the benefit of a payment holiday from certain pre-moratorium debts.[39] Some pre-moratorium debts, such as the obligation to pay debts or liabilities arising under financial contracts, are still required to be paid. The other category of debts that must be paid in the moratorium period are moratorium debts, namely any debt or other liability to which a company becomes subject during the moratorium other than by reason of an obligation incurred before the

[32] E.g. US Chapter 11 (11 USC §362; 365(e) and 541(c)), Singapore Insolvency, Restructuring and Dissolution Act 2018, ss. 64-66, and EU Restructuring Directive 2019/1023, Arts. 6-7.

[33] The only options for a statutory stay in debt restructuring were the automatic stay attached to administration (Insolvency Act 1986, Sch. B1, paras. 42-3) and the small company moratorium available in CVAs related to small companies (Insolvency Act 1986, s. 1A and Sch. A1, now abolished by CIGA).

[34] Alternatively, the debtor might twin the scheme with administration to make use of the statutory stay attached to that mechanism, or request the court's assistance to grant a stay (*Bluecrest Mercantile BV; FMS Wertmanagement AÖR v Vietnam Shipbuilding Industry Group* [2013] EWHC 1146 (Comm)) although this option was not well-developed.

[35] Many debt restructurings do exclude certain creditors and therefore do involve such a small homogenous group. This is one reason why the UK debt restructuring regime seems to have existed satisfactorily without a restructuring moratorium for many years. The other is the existence of a market for distressed debt so that creditors can sell their debt rather than challenge the restructuring or take enforcement action: S. Paterson, "Rethinking the Role of Corporate Bankruptcy Theory in the Twenty-First Century" (2016) 36 O.J.L.S. 697.

[36] CIGA, ss. 1-6 and Schs. 1-8 and J. Payne, "An Assessment of the UK Restructuring Moratorium" [2021] L.M.C.L.Q. 454.

[37] Insolvency Act 1986, Part A1, Chapter 2, s. A3 (but see CIGA, Schs. 4 and 8).

[38] Insolvency Act 1986, Part A1, Chapter 4.

[39] Pre-moratorium debts are: (a) any debts or liabilities to which the company becomes subject before the moratorium comes into force; or (b) any debt or liability to which the company has become or may become subject to during the moratorium by reason of any obligation incurred before the moratorium: Insolvency Act 1986, s. A18(3).

moratorium came into force, and any debt or other liability to which the company has become or may become subject after the end of the moratorium by reason of any obligation incurred in the moratorium. Any unpaid moratorium debts and some pre-moratorium debts without a payment holiday, described as “priority pre-moratorium debts”, then get super priority in an insolvency occurring within 12 weeks of the end of the moratorium.[40]

The period of the moratorium is just 20 business days initially, which can be extended for a further 20 days without creditor consent or a court order.[41] There are constraints on the sorts of companies that can utilise the moratorium, such as banks, insurance companies and companies involved in certain financial market transactions.[42] There are also eligibility requirements before a moratorium can be put in place, including that the directors must state that in their view the company is, or is likely to become, unable to pay its debts.[43] A monitor is appointed to provide some oversight of the operation of the moratorium. The monitor has a range of functions, including bringing the moratorium to an end by filing a notice at court if they think that the moratorium is no longer likely to result in the rescue of the company as a going concern or if the company is unable to pay moratorium debts which have fallen due.[44]

iii) Broad constraints on the use of *ipso facto* clauses

CIGA introduced a further constraint on creditors’ rights during certain restructurings,[45] specifically by constraining their ability to utilise *ipso facto* clauses.[46] Such constraints are intended to deal with the difficulty that companies in distress can face whereby suppliers stop or threaten to stop supplying the company. Those suppliers may rely on the right to terminate the contract because of the company’s insolvency, and may use this threat to require the payment of all arrears as the price for continued supply and/or to change the terms of the contract with the company, perhaps by increasing prices for the goods or services. This can make the ongoing trading of the business, or the sale of the business as a going concern, more challenging and potentially reduces the return to creditors. The English regime prior to CIGA was very limited, being focused on preserving the supply to financially distressed companies of facilities such as gas, water and electricity and “essential supplies” such as IT services, by constraining the use of *ipso facto* clauses by these suppliers.[47] The provisions introduced by CIGA

[40] Insolvency Act 1986, s. 174A (certain debts are excluded: s. 174A(3)(4)).

[41] Part A1, Chapter 3, s. A9.

[42] Schedule ZA1. Some of these exclusions are problematic. In particular, any company that is party to a capital market arrangement is excluded and this is defined to include arrangements of more than £10m which involve a party providing security to a trustee or agent or guaranteeing or providing security in respect of the performance of another party under a capital market investment, including rated/listed bonds (Sch. ZA1 paras. 13-14) which seems likely to remove many large corporates from the ambit of the provisions.

[43] Part A1, Chapter 3, ss. A6(1)(d).

[44] Part A1, Chapter 5, s. A38(1). See *Minor Hotel Group MEA DMCC v Dymant* [2022] EWHC 340 (Ch).

[45] The list includes the restructuring moratorium, administration, and a restructuring plan, but not schemes of arrangement (s. 233B(2)).

[46] Insolvency Act 1986, s. 233B. See J. Sarra, J. Payne and S. Madaus, “The Promise and Perils of Regulating *Ipso Facto* Clauses” (2022) 31 I.I.R. forthcoming.

[47] Sections 233, 233A.

are much broader and apply to contracts for the supply of goods and services generally, subject to certain exceptions.[48]

The provisions introduced by CIGA have two main effects.[49] First, a supplier's contractual right to terminate on the grounds of insolvency is permanently switched off as from the date of the relevant insolvency procedure. The prohibition is on termination or "any other thing"[50] by reason of insolvency. This includes exercising any other contractual rights triggered by or exercisable upon the commencement of an insolvency procedure and includes any provision requiring higher payments or payments on default, for example default interest or an acceleration of unpaid payments. Second, a supplier's contractual right to terminate on the grounds of any pre-insolvency events of default are temporarily suspended until the relevant insolvency procedure comes to an end (unless the company exits into a subsequent insolvency procedure).[51]

2. The UK's exit from the EU

UK debt restructuring mechanisms have proved popular as restructuring tools for non-UK companies. This has been particularly true of schemes of arrangement. The definition of "company" for scheme purposes encompasses foreign companies,[52] although the English courts will not exercise their power to sanction a scheme involving a foreign company unless a sufficient connection with England is shown[53] and there is a reasonable prospect of the scheme being effective, having particular regard to its prospects for recognition in other relevant jurisdictions.

Prior to the UK's exit from the EU, and the end of the transition period on 31 December 2020, the issue of the English court's jurisdiction to sanction schemes relating to foreign companies was complicated by EU legislation, in particular the Recast Insolvency Regulation[54] and the Recast Judgments Regulation.[55] These Regulations, particularly the latter, potentially impacted on the English court's ability to sanction a scheme of arrangement involving a company with creditors in other EU Member States.[56] While the Judgments Regulation proved difficult for the English courts to apply in the context of determining whether they had discretion to sanction such a scheme of arrangement, it had one significant upside in that it helped to satisfy the second part of the test set out above, namely to convince the English court that there was a reasonable prospect of the scheme being recognised in other jurisdictions in which the company operated, owned assets, or in which dissenting creditors

[48] Schedule 4ZZA. Excluded contracts include loan agreements, hedging agreements and other types of financial contracts. There is also a carve-out for any set-off, netting arrangements or capital market investments.

[49] See Insolvency Act 1986, s. 233B(3)(4).

[50] Section 233B(3).

[51] Sections 233B(4) and 233B(8).

[52] Companies Act 2006, s. 895(2)(b); Insolvency Act 1986, s. 221 and see *Re Sovereign Marine & General Insurance Co Ltd* [2006] EWHC 1335 (Ch); [2006] B.C.C. 774.

[53] E.g. *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch); *Re Drax Holdings Ltd* [2003] EWHC 2743 (Ch); [2004] 1 W.L.R. 1049; *Re Primacom Holdings GmbH* [2012] EWHC 164 (Ch); [2013] B.C.C. 201.

[54] Regulation (EU) 848/2015.

[55] Regulation (EU) 1215/2012.

[56] J. Payne, "Cross-border schemes of arrangement and forum shopping" [2013] E.B.O.R. 563. See *Re DAP Holding NV* [2005] EWHC 2092 (Ch); [2006] B.C.C. 48; *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch); *Re Gansewinkel Groep BV* [2015] EWHC 2151 (Ch); [2015] B.C.C. 172.

might take action. Under the Recast Judgments Regulation "[a] judgment given by a Member State shall be recognized in other Member States without any special procedure being required".[57] Accordingly, an English court's sanctioning decision in a scheme of arrangement could be automatically recognised and given effect under this Regulation in other Member States.

From 1 January 2021 both the Recast Insolvency Regulation and the Recast Judgments Regulation ceased to apply in the UK. As a result, the latter is no longer available as a means for English schemes of arrangement, or restructuring plans,[58] to be recognised by the courts in EU member states. This in turn impacts on the English court's ability to sanction schemes of arrangement and restructuring plans involving companies with creditors in other EU countries unless alternative means of recognition are found.

III. The shift to a more debtor-friendly regime

The first substantial effect on UK debt restructuring of the changes discussed in part II is a shift towards the UK regime being more debtor-friendly. These result from the changes introduced via CIGA. Debt restructuring regimes involve constraints being placed on individual creditors' rights in order to facilitate a beneficial outcome for the debtor, and creditors generally. A legal regime needs to determine the appropriate balance between these groups, building in a level of protection for minority creditors that will benefit those creditors, but also acting to bolster the market for capital, since the risk of expropriation *ex post* will be factored in by creditors lending money to companies *ex ante*. Different regimes make different calculations about the appropriate balance between debtors and creditors.[59] Relevant factors include the jurisdiction's attitude towards the initiation of restructuring, the existence and extent of any statutory stay, the fate of incumbent management, the treatment of dissenting creditors, and the role of the courts. Prior to CIGA the UK was regarded as largely creditor-friendly but the changes introduced by CIGA mark a shift in the balance of its debt restructuring regime. Greater constraints are imposed on creditors via the cross-class cramdown of the restructuring plan, the restructuring moratorium and the changes regarding *ipso facto* clauses. While some new minority protections have been introduced to address these enhanced constraints, the balance of the UK regime has undoubtedly shifted to one which is more debtor-friendly as a result of these changes, and perhaps just as importantly the perception of the market is that the changes have resulted in a such a shift. One important feature of these changes is the extent to which the balance between debtors and creditors, particularly dissenting creditors, is left to the courts to determine. The provisions in CIGA leave substantial discretion to the court to determine the extent of minority creditor protection. This means that the precise nature of the balance and how substantial this shift to debtors has been will take some time to emerge, as judges have the opportunity to consider and determine these issues. During this time an element of uncertainty will exist for debtors and creditors.

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[57] Regulation (EU) 1215/2012, Art. 36(1).

[58] The restructuring plan procedure applies in relation to any company liable to be wound up under the Insolvency Act 1986, which therefore includes foreign companies (Companies Act 2006, s. 901A(4)) with a similar eligibility test to that which applies for a scheme of arrangement see e.g. *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2191 (Ch); [2020] B.C.C. 997).

[59] See "Insolvency Regimes and Productivity Growth: A Framework For Analysis" OECD Working Papers No. 1309, July 2016.

1. The shift towards debtors as a result of the introduction of restructuring plans

The most significant innovation within the restructuring plan is the cross-class cramdown. This is obviously a more significant constraint on creditors' rights than the cramdown within a class that is achievable via a scheme of arrangement alone and therefore shifts the balance in favour of debtors.

With this increased constraint on creditor rights comes the need for additional minority protection. The question that arises is the extent of this protection and how pro-debtor these reforms are in practice. The minority protections in schemes of arrangement (the division of creditors into classes and court oversight of the restructuring) are insufficient protection for creditors in a cross-class cramdown. This is because schemes of arrangement require all classes to consent and therefore the protections are designed to ensure that the minority are only bound by like-minded individuals who have similar incentives and views on the restructuring, so the minority can to a large extent rely on the majority acting self-interestedly in a way that is aligned with the minority.[60] By contrast, in a restructuring plan, the restructuring can go ahead despite the dissent of one or more classes of creditors. Even if like-minded creditors gather to vote on the plan, the fact that the dissent of a whole group can be ignored raises concerns about wealth transfers. For example, senior creditors could act with the directors to reorganise the debtor in a way that excludes the claims of the junior creditors, leaving the senior creditors with all (or the lion's share) of equity and debt in the debtor company, and leaving the subordinated classes with little or nothing after the restructuring. Faced with such a situation the court will need to determine whether to approve a plan that excludes the junior creditors in this way. It may, after all, be a reasonable way forward where the financial distress of the debtor is such that there are only sufficient assets available to pay the senior creditors. Fundamentally, the court will want to assess what value each class of creditors had before the restructuring, and what they have afterwards to see if an inappropriate wealth transfer has taken place. This analysis will need to balance the protection of minority creditors with a desire to prevent the minority exercising hold-up rights in a manner that inappropriately extracts value and threatens the successful outcome of the plan.

At the heart of this issue is the difficult question of who should retain a continuing stake in the company or business. This turns on the question of valuation in a restructuring context. In an insolvency scenario this is relatively straightforward. Insolvency law imposes a collective process to minimise individual enforcement so that the business can be kept together and sold for a higher price. The value of the business is determined by a sale of the business or its assets to a third party, usually in some form of auction process. Insolvency law may include safeguards against the sale being at too cheap a price, but the value can readily be determined in this way. In a going concern sale or auction process the question of valuation is removed from the ambit of the creditors and from the court and is a matter for the market to determine. The division of the assets obtained in the sale amongst the creditors is also straightforward: the firm's value is distributed according to the priorities of the parties. By contrast, in a reorganisation there is no sale to a third party. The existing creditors have committed to remain within the company and to continue to fund it. Without a sale to a third party some other form of valuation mechanism is required, and questions of valuation are therefore often at the heart of discussions around restructuring.

[60] See J. Payne, "The Role of the Court in Debt Restructuring" [2018] C.L.J. 124.

Different jurisdictions have adopted different mechanisms to ensure that the minority creditors are protected in this scenario. One of the best known is the absolute priority rule (APR) in US Chapter 11,[61] which is one part of the US court's analysis of whether to approve a plan, although it has been said to be more honoured in the breach than the observance.[62] It has faced criticism in recent years,[63] and other regimes introducing cross-class cramdowns have either done so with a modified APR or an alternative. The EU Restructuring directive, for example, introduces a relative priority rule (RPR) as an alternative to the APR.[64] These mechanisms start from the issue of priorities, which is of relevance in the context of insolvency. The APR requires that the plan must pay any non-consenting class in full before any junior class receives anything under the plan.[65] The EU RPR provides that dissenting voting classes of affected creditors must instead be treated at least as favourably as any other class of the same rank and more favourably than any junior class.[66]

Discussions around priorities can however obscure the question which the court is fundamentally being asked to determine in a restructuring, namely whether the dissenting creditors are being treated fairly both by reference to the position if the restructuring were not to occur, and as regards their ability to share in the surplus generated by the restructuring over and above the value arising if no restructuring takes place (the restructuring surplus). The UK restructuring plan does not adopt any form of APR or RPR. Instead, it focuses on the question whether members of a dissenting class would be any worse off than they would be in the event of the relative alternative (the "no worse off" test)[67] together with the same "just and equitable" standard that applies at present when courts determine whether to sanction a scheme of arrangement. It is the latter analysis which can enable the distribution of the restructuring surplus to be taken into consideration.[68]

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[61] 11 U.S.C. §1129(b)(2)(B).

[62] E.g. *Czyzewski* v*. Jevic Holding Corp* 137 S. Ct. 973, 979 (2017).

[63] D. G. Baird, "Priority Matters: Absolute Priority, Relative Priority, and the Costs of Bankruptcy" (2017) 165 U. Pa. L. Rev. 765; E. J. Janger, "The Logic and Limits of Liens" [2015] U. Ill. L. Rev. 589; S. J. Lubben, "The Overstated Absolute Priority Rule" (2016) 21 Fordham J. Corp. & Fin. Law 581. See also American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11*, 2012–2014: *Final Report and Recommendations* (2014).

[64] EU 2019/1023, Art. 11(1)(c). This is different to the relative priority rule that has been proposed by US academics as an alternative to the APR, see D. G. Baird, "Priority Matters: Absolute Priority, Relative Priority, and the Costs of Bankruptcy" (2017) 165 U. Pa. L. Rev. 765.

[65] Criticisms regarding the rigidity of this rule has led some legislators to build in some flexibility; the Dutch scheme of arrangement for example provides for the absolute priority rule to apply "unless there are reasonably grounds for…deviation" from the rule (Dutch Act on the Confirmation of Extrajudicial Restructuring Plans, Art. 384(4)(b).

[66] See L. Stanghellini, R. Mokal, C. Paulus and I. Tirado (eds.), *Best practices in European restructuring. Contractualised distress resolution in the shadow of the law* (Milan: Wolters Kluwer, 2018); T. Richter and A. Thery, *INSOL Europe: Guidance Note on the Implementation of Preventive Restructuring Frameworks under EU Directive 2019/1023: Claims, Classes, Voting, Confirmation and the Cross-Class Cram-Down*, April 2020; R. Mokal "The court's discretion in relation to the Pt 26A cram down" [2021] J.I.B.F.L. 12; A. Krohn, "Rethinking priority: The dawn of the relative priority rule and the new "best interests of creditors" test in the European Union" (2021) 30 I.I.R. 75.

[67] Companies Act 2006, s. 901G(5).

[68] This has some advantages over the APR in US Chapter 11. The "floor" below which dissentients entitlements may not fall is lower: in US Chapter 11 this is the face value of the dissentients' claims whereas in the

The approach of the English courts to valuation is therefore to have regard to the price that the business would fetch in the market if sold on the date of the reorganisation, effectively treating the business as being sold to the existing creditors.[69] This has the benefit of flexibility, allowing the valuation to be on a going concern or break-up basis as relevant and it has the advantage of providing an objective measure, avoiding the bargaining and litigation approach of the US Chapter 11 regime.[70] It does include some potential pitfalls, however. It relies on a level of expertise by the judge to determine the relevant alternative and to reach a decision on the appropriate valuation. Determining a going concern valuation can be tricky. As there is no actual sale, this figure can be determined in various ways. It may be assessed based on market valuation opinions provided by expert valuers which can lead to costly and lengthy valuation fights between the parties which can be difficult for the court to mediate. Alternatively, it can be based on market price valuation testing of the business, which is sometimes said to be preferable[71] but could be open to misuse by the senior creditors if they utilise a temporary dip in the market to exclude the junior creditors.

Much is left to the judges themselves to determine, including the assessment of the "relevant alternative", the appropriate method of valuation, and, perhaps most challenging of all, how the restructuring surplus should be distributed once the "no worse off" test has been satisfied. In *Re Virgin Active Holdings Ltd*[72] the court had the chance to consider the first contested cross-class cramdown in a restructuring plan. The restructuring plans in this case were designed by the three companies within Virgin Active (the plan companies) to enable them to continue in existence and trade profitably by reducing the existing unsecured debt and provide for the provision of new money. This also carried the possibility of the shares in the three plan companies increasing in value from future trading, thereby potentially benefitting the shareholders. One group of creditors contested the plans, arguing inter alia that shareholders should not enjoy the possible benefits of the plans. The plan companies contended that the alternative scenario for the purpose of the "no worse off" test was administration, followed by an accelerated business sale, and this was not disputed. The court reiterated the importance of protecting dissenting creditors in this process but also noted the importance of not allowing lengthy valuation disputes to undermine the utility of the restructuring plan provisions. On the facts the court determined that the "no worse off" test was satisfied and the questions therefore revolved around the allocation of the restructuring surplus.[73] It was determined that the creditors contesting the plan were out of the money and therefore their objections to the allocation of this surplus carried little or no weight; essentially it was for those creditors with a remaining economic interest in the company to determine how to divide up any restructuring surplus.[74] On different facts,

restructuring plan it is the return they would receive in the relevant alternative, which could be zero for junior creditors if the relative alternative is liquidation and the value breaks in the senior debt. This more flexible approach can be valuable.

[69] This assumes that the relevant alternative is a going concern sale of the business and assets.

[70] D.G. Baird and D.S. Bernstein, "Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain" (2006) 115 Yale L.J. 1930.

[71] D. G. Baird, "Bankruptcy's Uncontested Axioms" (1998) 108 Yale L.J. 573.

[72] [2021] EWHC 1246 (Ch). See also *Re Amicus Finance Plc* [2021] EWHC 3036 (Ch).

[73] Cf. *Re Hurricane Energy Plc* [2021] EWHC 1759 (Ch); [2021] B.C.C. 989 in which the "no worse off" test was not satisfied and the court declined to sanction the restructuring plan.

[74] Another way to exclude out-of-the-money shareholders/creditors is at the convening stage via s. 901C(4) Companies Act 2006, such that they do not vote on the restructuring plan at all: *Re Smile Telecoms Holdings Ltd* [2022] EWHC 387 (Ch).

where the battle is between equal ranking classes that are "in the money", the court is likely to look closely at two factors: whether the proposed compromise with the assenting class is a real compromise or a manipulation of the classes, and whether the dissenting class received a share of the enterprise's value that is in some way proportionate to the compromise they are being asked to make. This seems like the right question for the court to ask, though this analysis may prove contentious especially where the relevant alternative is disputed.

This approach is largely in line with that taken by the courts in cases where schemes have been twinned with administration in the past to achieve a *de facto* cross-class cramdown.[75] Nevertheless the introduction of a statutory *de jure* cross-class cramdown mechanism is a departure which has been perceived as marking a new, more pro-debtor stance for English restructuring law, particularly when combined with the restructuring moratorium, discussed next. Exactly how pro-debtor it is will depend to a large extent on the court's approach in balancing the debtor's interests with those of creditors, particularly dissenting creditors. The approach adopted in *Virgin Active* and other decisions to date[76] is an encouraging start, but questions remain to be answered, particularly where the "relevant alternative" is disputed.

2. The shift towards debtors as a result of the restructuring moratorium

The restructuring moratorium represents a significant shift towards debtors in debt restructurings. Previously the most common means by which debtors protected themselves from creditors enforcing their claims or initiating insolvency was to negotiate a contractual standstill arrangement with their creditors, which provided creditors with complete control since no arrangement could be imposed upon them. By contrast the restructuring moratorium constrains creditors from exercising a range of rights during this period, and this extends to all creditors of the company, not just the subset involved in the restructuring.

A moratorium can clearly be beneficial from a debtor's perspective during the period that a restructuring is negotiated and implemented but it poses a threat to creditors, who may be concerned about the misuse of this tool by the debtor. A moratorium can be used to prop up an economically unviable company, thereby prolonging the moment when the company's difficulties are tackled. Alternatively, it can be utilised by a viable company in order to shake off liabilities that the company is perfectly capable of meeting. CIGA introduces various protections to address these concerns. These include keeping the period of the moratorium short (just 40 days unless creditors consent or a court order is obtained), and various eligibility requirements. For example, the requirement that directors must state that in their view the company is, or is likely to become, unable to pay its debts may be seen as a means of protecting creditors against the second of the concerns stated above, namely the misuse of the moratorium by a viable company seeking to shake off its debts. The role of the monitor can also be seen as relevant in this context. The requirement for proposed monitors to state that in their view it is likely that the moratorium will result in the rescue of the company as a going concern addresses the first concern set out above, namely the use of the moratorium where the company is unviable. Another important form of protection is the ability of creditors to challenge the moratorium

[75] See *Re Bluebrook Ltd* [2009] EWHC 2114 (Ch) and J. Payne, "Debt restructuring in English Law: Lessons from the US and the need for reform" (2014) 130 L.Q.R 282.

[76] See e.g. *Re Hurricane Energy Plc* [2021] EWHC 1759 (Ch); *Re Amicus Finance Plc* [2021] EWHC 3036 (Ch) [Smile?].

in certain circumstances where they have suffered "unfair harm".[77] This could be based on the actions of either the monitor or directors. The court is given broad powers to make any order it thinks fit including bringing the moratorium to an end.[78] Exactly what "unfair harm" means in this context is largely left for the courts to develop.

3. The shift to debtors as a result of the new constraints on ipso facto clauses

The new constraints on the operation of *ipso facto* clauses are in some ways the most innovative aspect of the CIGA provisions; whereas *de facto* cross-class cramdown was possible prior to CIGA and a restructuring could access a moratorium by combining with administration, the constraints on *ipso facto* clauses prior to 2020 were very limited in scope and the changes in CIGA extend their reach significantly. The introduction of the broad constraints on *ipso facto* clauses in CIGA is particularly surprising given the importance of the principle of freedom of contract in English law. Since the nineteenth century the starting point for the courts has been the idea that when entering contracts parties are free to decide when and in what circumstances that contract should come to an end.[79] While there have been inroads into this principle in the context of insolvency law,[80] these inroads have been comparatively limited. The new restructuring moratorium combined with the broad and far-reaching constraints on *ipso facto* clauses introduced via CIGA therefore represent a material policy shift from creditors to debtors.

While restricting creditors' freedom of contract in this way can be potentially beneficial to the debtor, if it allows the assets to be kept together while the company is restructured or sold, it is potentially problematic for individual creditors who, instead of being able to reclaim all or a substantial proportion of the amount due to them, may find themselves receiving a smaller proportion following the restructuring or sale. The main form of creditor protection included within CIGA is the right for the supplier to terminate the contract in certain circumstances despite the existence of the legislative constraint.[81] In practice the most valuable basis for this to occur is likely to be the ability to ask for the court's approval to terminate, on the basis that continuation of the contract would cause the supplier hardship.[82] However, the concept of "hardship" is not defined within the legislation and it will therefore be for the courts to establish this threshold. It may be that the UK courts will apply the concept of balance that they have developed in relation to creditor challenges to the UK administration moratorium, whereby the hardship to the individual creditor is balanced with the benefits to the creditors as a whole in light of the overarching aim of securing the rescue of the company or business. A high hurdle is imposed on the individual creditor: the court will relax the prohibition where it is demonstrated that it would be inequitable for the prohibition to apply.[83] If a similar threshold is applied to this scenario, it is likely that "hardship" will be interpreted to mean the

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[77] Insolvency Act 1986, Sch. A1, ss. A42, A44. See *Minor Hotel Group MEA DMCC v Dymant* [2022] EWHC 340 (Ch).

[78] Schedule A1, ss. A42(4)(5), A44(3)(4).

[79] *Printing and Numerical Registering Co. v Sampson* (1874-75) L.R. 19 Eq. 462, 465 *per* Sir George Jessel M.R.

[80] See *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 1 W.L.R. 758; [1975] 2 All E.R. 390; *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2011] UKSC 38; [2012] 1 A.C. 383.

[81] Insolvency Act 1986, s. 233B (5)(6).

[82] Section 233B(5)(c).

[83] *Re Atlantic Computer Systems Plc* [1992] Ch. 505; [1992] 2 W.L.R. 367.

possible insolvency of the supplier if it is forced to continue to supply.[84] Exactly how pro-debtor these provisions are in practice will depend on the approach adopted by the courts to this issue.

Transitional effects

The introduction of a *de jure* statutory cross-class cramdown, together with the introduction of a debtor-in-possession restructuring moratorium and broad constraints on *ipso facto* clauses represent a significant pro-debtor shift in the UK debt restructuring regime. There are protections for dissenting and minority creditors built into the legislative regime. However, these at best mitigate rather than reverse the debtor-focused changes. Neither do they undermine the perception that these changes move the UK regime in a more pro-debtor direction. Furthermore, to the extent that creditor protection is provided, the extent of this protection (and thus the balance between debtors and creditors) is to a significant extent left to the courts to develop. This can be seen, for example, in the significant discretion given to the courts to determine whether a cross-class cramdown should go ahead, the ability of minority creditors to challenge a moratorium on the grounds of unfair harm and the ability of suppliers to apply to court for permission to terminate on the basis of the hardship they would otherwise suffer. To some extent the exact balance between the two will only be observable once the courts have had the chance to consider these issues in detail. While the courts have a history of dealing with debt restructuring issues in a pragmatic, commercially sensible manner, it will take time for jurisprudence on these issues to develop. In the meantime, an element of commercial risk exists for the parties, particularly for creditors unsure of the precise parameters of the protection they will receive.

We are therefore in a period of transition while these issues are developed by the courts and while the response of creditors to these changes becomes clear. Parties may change their behaviour as regards their willingness to lend, the terms on which they will lend including the price of the lending, and also the jurisdiction in which they are willing to operate. Debt restructuring of the kind discussed in this article is the preserve of large companies for the most part,[85] and the creditors most directly affected are institutional creditors, banks, hedge funds and other major lenders in the credit markets. These creditors are global players and can generally take their business elsewhere if they choose to do so. It remains to be seen whether the creditor protections introduced in CIGA will be sufficient to offset the risks introduced by these changes. These reforms may well have been introduced partly to respond to concerns about the need to keep the UK at the forefront of debt restructuring, but a strong pro-debtor approach, while attracting debtors, is likely to be less attractive for creditors if they have viable lending options elsewhere.

IV. The development of a modular system

A second consequence of the changes introduced by CIGA is the development of a modular approach to debt restructuring. It is notable that, unlike other regimes which have integrated the moratorium into their debt restructuring mechanism, the UK reforms have not done so. In US Chapter 11, for example, the moratorium is very much part of the debt restructuring mechanism. By contrast, in the

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[84] This hardship test has been described as a "safeguard of last resort", suggesting that it may be of limited value to suppliers: House of Commons Library Briefing Paper, No. 8922, 1 June 2020, 30.

[85] Although see *Re Amicus Finance Plc* [2021] EWHC 3036 (Ch).

UK regime post-CIGA the restructuring moratorium is a standalone device and debtors can opt whether to utilise it in a restructuring.

This approach seems to recognise the distinction between insolvency and restructuring, an issue discussed in more detail in the next section. A restructuring moratorium can be seen as responding to both the anticommons problem and common pool problem. Since insolvency aims to provide a collective process and to minimise the incentives and opportunities for individual enforcement, a moratorium is essential to the process. Hence the automatic moratorium attached to administration in the UK. By contrast a restructuring mechanism such as a scheme of arrangement or a restructuring plan involves a new agreement being struck between the existing creditors who wish to stay invested in the company. While a restructuring therefore needs to deal with the anticommons problem, the common pool problem does not necessarily arise. Of course, there may on occasion be a minority of creditors in a restructuring with their own idiosyncratic reasons for preferring to enforce, but this will not always be the case. Hence, an optional moratorium in restructuring, such as that introduced by CIGA, is sensible.[86]

This principal benefit of this modular approach is flexibility: debtors have a great deal of freedom as to the mechanisms they can use to restructure their debt, and the nature of the constraints that this choice then imposes on their creditors. In some instances a moratorium may not be needed since the subset of creditors involved in the restructuring have no desire to disrupt it, or alternatively are happy to enter into a contractual standstill arrangement in order to voluntarily constrain their actions. Even if a moratorium might otherwise be valuable for a debtor, some distressed companies may be wary of announcing a moratorium because of the unwanted publicity this may draw to their financial position.

However, there are downsides to this modular approach. In particular, there is a danger of inconsistency of approach. Instead of a single restructuring tool with one type of moratorium attached to it, the UK regime now has multiple restructuring mechanisms (schemes of arrangement, CVAs, administration, contractual workouts and restructuring plans) which operate in quite different ways, including regarding their availability and the extent of the constraints on creditor rights, and two different moratoria (the restructuring moratorium and the moratorium attached to administration). The problems regarding different forms of restructuring mechanisms existed even before CIGA, but CIGA has exacerbated this by adding a new mechanism which is quite distinct from pre-existing restructuring options. While the Explanatory Notes accompanying CIGA emphasise the "overall commonality" between schemes of arrangement and restructuring plans, they also acknowledge that there are differences between the two.[87] It is left to the courts to determine the extent to which parallels can or cannot be drawn between these mechanisms.[88] One example of differential treatment

[86] The fact that the US Chapter 11 procedure contains an automatic moratorium can be explained on the basis that this is fundamentally a bankruptcy process that has been re-purposed for restructurings

[87] Explanatory Notes accompanying the Corporate Insolvency and Governance Act 2020, para. 16. See *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2191 (Ch). The courts have also sought to find parallels between other restructuring tools, such as the minority protection available in schemes of arrangement and CVAs, see *Re T & N Ltd* [2004] EWHC 2361 (Ch); [2005] 2 B.C.L.C. 488.

[88] See e.g. *Re Hurricane Energy Plc* [2021] EWHC (Ch) per Zacaroli J. regarding the importance of keeping in mind the differences between schemes and restructuring plans especially when dealing with a cross-class cramdown.

between the two is provided in *Re Gategroup Guarantee Ltd,*[89] discussed in part V, in which the judge drew a distinction between the relevance of the Lugano Convention to restructuring plans and schemes, creating potentially difficult questions for debtors having to choose between the two regimes.

By contrast, prior to CIGA there was only one moratorium, that attaching to administration, and the addition of a second has created a new potential for inconsistency. There are some similarities between the two mechanisms. For example, the list of restricted behaviour for creditors during a moratorium are very similar.[90] But there are some quite significant differences, both in terms of content and operation. For example, a restructuring moratorium can be entered into by simply filing documents at court.[91] There is no requirement to obtain the consent of (or even notify) a qualifying floating charge holder or other secured lender in advance. A qualifying floating charge holder will be notified of the restructuring moratorium by the monitor alongside other creditors once it is in force. Therefore, in contrast to administration, a qualifying floating charge holder lacks control in a restructuring moratorium, being unable to "veto" the directors' choice of insolvency practitioner. Another difference exists regarding the distributional outcomes for creditors in the two moratoria. Where an insolvency event occurs within 12 weeks of the expiry of a restructuring moratorium, moratorium debts and priority pre-moratorium debts (namely those debts for which the company does not have a payment holiday) have super-priority,[92] in contrast to the situation in administration.

Transitional effects

The modular nature of the UK debt restructuring regime, and more specifically the differences between the different restructuring mechanisms and the different moratoria, are likely to drive changes in debtor and creditor behaviour, although the precise nature of these changes remains to be seen. For example, the differences highlighted above provide lenders with incentives to bring a restructuring moratorium to an end. Entering a moratorium will in many cases constitute an event of default that will automatically accelerate the entire debt. Even in those cases where acceleration is not automatic, it may be open to lenders to issue a notice accelerating their debt to make it payable on demand during the moratorium period and thus regain some control given that the company is unlikely to be able to pay. If the entire debt is accelerated, it becomes due and payable during the moratorium period. Consequently, if the company cannot pay, which is likely to be the case, then either the monitor would need to bring the moratorium to an end, on the basis that they no longer believe the company can be rescued as a going concern, or the company would have to negotiate with the lender to agree a stay. If a stay cannot be agreed, then such an acceleration could enable the lender to re-take control of the process via an administration appointment or other enforcement process once the restructuring moratorium terminates.

These changes might create other incentives. One consequence of the changes to the order of priority where a company enters administration or insolvent liquidation within 12 weeks of a restructuring moratorium ending is that it grants super-priority to certain pre-moratorium unsecured debts which

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[89] [2021] EWHC 304 (Ch); [2021] B.C.C. 549.

[90] See Insolvency Act 1986, Part A1, Chapter 4, ss. A20-A23 (restructuring moratorium), Sch. B1, paras. 42-43 (administration moratorium).

[91] Part A1, Chapter 2. Administrators can also be appointed out of court.

[92] Section 174A.

means that they will rank above other debts, potentially including financial debts secured by a floating charge. Lenders with super-priority debts therefore have an incentive to ensure that the company enters administration or insolvent liquidation within 12 weeks of the end of the restructuring moratorium. It is therefore possible that creditors that are owed debts falling into this category will change their approach to restructuring, requiring a company to first file for a restructuring moratorium before entering a subsequent insolvency process, simply to produce this super priority result. This behaviour could frustrate a longer-term rescue of a company.

These are just two examples of changes in behaviour that might be expected to flow from these changes. No doubt there are others that may arise as a result of debtors, creditors and their advisers seeking ways to make this modular approach work well for them, even if the outcome is to undermine the overall goal of corporate rescue. These issues need to be considered in combination with the issues discussed in part III which also provide the parties, particularly creditors, with incentives to renegotiate their relationship with the debtor, or find other lending opportunities.

V. Restructuring vs insolvency

Another issue that these developments have exacerbated is a blurring of the line between restructuring and insolvency.[93] Intellectually a distinction can be drawn between the two concepts, as discussed in part II. Insolvency is fundamentally the process of reallocating the capital of the financially distressed company once the existing creditors (particularly the financial creditors) have decided they no longer want to be involved in it. A restructuring by contrast involves the existing creditors agreeing to stay within the company, but a reorganisation of capital is needed to reflect the new bargain. The line between these two had begun to blur even before the changes discussed in part II took place. A pre-pack administration, for example, is an insolvency process but can be used as a way of selling the business to existing senior lenders.[94] Further blurring the lines, pre-pack administrations are sometimes combined with schemes of arrangement as a means of dealing with out-of-the-money junior creditors in a debt restructuring scenario.[95]

The tools introduced via CIGA exacerbate this blurring effect. Previously a moratorium was effectively the preserve of insolvency mechanisms[96] whereas now the restructuring moratorium has expanded the availability of this device to restructurings. At the same time, while schemes of arrangement can be utilised at any point in the company's solvency or insolvency, as there are no financial conditions attached to their use, restructuring plans are focused on a much narrower period of time, when the

[93] See S. Madaus, "Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law" [2018] E.B.O.R. 615.

[94] The sale need not be to existing creditors, but this is a common outcome: See P. Walton and C. Umfreville, *Pre-Pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration*, April 2014; Insolvency Service, *Pre-pack Sales in Administration Report*, 8 October 2020. Pre-packs have attracted criticisms, particularly when the sale is to a party connected with the company: S. Frisby, *A Preliminary Analysis of Pre-packaged Administrations* (Report to the Association of Business Recovery Professionals, August 2007; Insolvency Service, *Pre-pack Sales in Administration Report*, 8 October 2020.

[95] *Re Bluebrook Ltd* [2009] EWHC 2114 (Ch).

[96] The exception was the(now abolished) moratorium attached to small CVAs but these were rarely used in practice: see P. Walton, C. Umfreville, L. Jacobs, *Report for R3: Company Voluntary Arrangements: Evaluating Success and Failure*, May 2018 .

company has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern.[97] The purpose of the restructuring plan must then be to prevent or mitigate the effect of the company's financial difficulties. While the company need not actually be insolvent, there is clear overlap between the circumstances in which an insolvency process and a restructuring plan can be utilised. This has led to questions around whether a restructuring plan can be regarded as an "insolvency proceeding".

This is an issue of potential importance given that various legislative instruments utilise this term as a means or drawing a boundary between those mechanisms that are within the purview of the instrument, and those that are outside it. For example,[98] the Lugano convention governs jurisdiction and the enforcement of judgments between EU Member States and certain states that are members of the European Free Trade Association (EFTA).[99] However, the Lugano Convention does not apply to "bankruptcy, proceedings related to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings".[100] In *Re Gategroup Guarantee Ltd*,[101] the English court had to determine whether a restructuring plan fell within this bankruptcy exception, that is whether it should be regarded as an insolvency proceeding for this purpose. The restructuring plan in this case was designed to amend and extend the senior debt and bond liabilities in order to give the company breathing space to trade through the Covid-19 pandemic. The bonds contained an exclusive jurisdiction clause in favour of the Zurich courts. While from 1 January 2021 the UK is no longer party to the Lugano Convention, the restructuring plan was issued prior to that date, so the Lugano Convention potentially still applied.

The judge considered that the issue turned on whether restructuring plans satisfied the following requirements: (i) they must be collective proceedings; (ii) they must be based on laws relating to insolvency and have as their purpose rescue, adjustment of debt, reorganisation or liquidation; and (iii) the assets and affairs of the debtor are subject to control or supervision of a court.[102] The judge found that these elements were satisfied for restructuring plans. In particular, the judge found that the presence of the financial threshold conditions for a restructuring plan meant that Part 26A of the Companies Act 2006 which contains restructuring plans is a law relating to insolvency for these purposes, notwithstanding that it sits within the Companies Act 2006 rather than insolvency legislation.

[97] Companies Act 2006, s. 901A(2).

[98] Another example is the question whether schemes of arrangement or restructuring plans are "insolvency-related events" under the Cape Town Convention and the related Aircraft Protocol. See *Re Nordic Aviation Capital Designated Activity Company* [2020] I.E.H.C. 445 at [162]-[164]; R*e MAB Leasing Ltd* [2021] EWHC 152 (Ch) and [2021] EWHC 379 (Ch); *Re AirAsia X Berhad*, in the High Court of Malaya in Kuala Lumpur, in the Federal Territory, Malaysia (Commercial Division), originating summons no.: WA-24NCC-467-10/2020.

[99] Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial matters, signed in Lugano on 30 October 2007.

[100] Article 1(2)(b).

[101] [2021] EWHC 304 (Ch).

[102] This is the test for insolvency proceedings within the EU Insolvency Regulation (EU) 848/2015, Art. 1(1) (although Art.1(1) provides for a broader range of circumstances than provided within condition (iii) of the text, the requirement included in the text is the most relevant to restructuring plans and it was the one on which the judge in *Re Gategroup* focused).

This decision is controversial,[103] not least because of the contrast with the approach taken in relation to schemes of arrangement, where the general assumption has been that they should not be regarded as insolvency proceedings.[104] In *Gategroup*, Zacaroli J. drew a distinction between restructuring plans and schemes of arrangement, on the basis that the latter contain no financial threshold conditions and can be used by solvent companies. However, the decision in *Gategroup* potentially re-opens the question of whether schemes of arrangements should be regarded as "insolvency proceedings" at least where those schemes are being utilised at the same point in the company's financial distress as restructuring plans; after all, in relation to the other three tests set out above schemes of arrangement and restructuring plans are not fundamentally distinct. However, there are reasons to doubt the application of these tests to restructuring plans, and by extension schemes of arrangement in equivalent financial circumstances.

It is worth pausing to consider the paradigm example of insolvency when thinking about the application of the three tests set out above. As discussed, insolvency is in essence a debt collection process whereby the existing creditors no longer wish to be involved; control of the company is transferred to an insolvency practitioner who sells the company to a third party or sells it off piecemeal and distributes the assets to the creditors in accordance with their priorities. As a debt collection exercise it is crucial that it is collective (all of the creditors must participate), the directors no longer have control of the company and the purpose of the exercise is to resolve the company's financial difficulties, in this instance via liquidation.[105] This is distinct from the typical debt restructuring exercise which involves the directors staying in control (albeit that the court has oversight of the restructuring) and typically involves a subset, potentially only a small minority, of the creditors. The restructuring may take place at a crisis point for the company in terms of its financial position (and the restructuring plan is designed to address this), but a scheme of arrangement can certainly be used at an earlier point in time.

What seems clear is that debt restructuring mechanisms like the UK restructuring plan are designed to achieve a different outcome from traditional insolvency mechanisms and therefore it is unsurprising that they do not fit comfortably within the definition of "insolvency procedures" that are found in various legislative instruments. Indeed, these definitions of insolvency existed long before restructuring plans were introduced.

Transitional effects

It has been left to judges to determine whether and to what extent restructuring plans might be regarded as insolvency procedures, since this matter is not addressed in legislation. The court in *Gategroup* came to an answer on whether restructuring plans should be regarded as insolvency proceedings for the purpose of the Lugano Convention, but there are various other legislative provisions where this question has not yet been settled.[106] These issues also need to be considered in

[103] See e.g. *Re Deep Ocean 1 UK Ltd* [2021] EWHC 138 (Ch) which proceeded on the basis that restructuring plans, like schemes of arrangement, are civil or commercial matters rather than matters of insolvency.

[104] This issue has been discussed in the context of the application of the Recast Judgments Regulation (EU) 1215/2012 to schemes. See J. Payne, *Schemes of Arrangement: Theory Structure and Operation*, 2nd edn (Cambridge: Cambridge University Press, 2021) ch. 7.2.

[105] See H. Eidenmüller, "What is an insolvency proceeding?" (2018) 92 Am. Bankr. L.J. 53.

[106] E.g. Hague Convention of 30 June 2005 on Choice of Court Agreements.

the context of schemes of arrangement. The answers to these questions have important consequences for the parties involved, such as whether a company can make use of the English court's jurisdiction for a restructuring plan. They also have potential consequences for the UK more generally. In *Gategroup*, for example, the fact that restructuring plans were held to be within the bankruptcy exception to the Lugano convention meant that the English court did not have jurisdiction in relation to the proposed restructuring plan. In recent years there has been a steady stream of foreign companies coming to the English courts to effect their restructurings, but decisions such as *Gategroup* impact their ability to do so and have implications for the UK's position as a debt restructuring centre. This issue is discussed further in part VI.

The question of determining the boundaries between restructuring and insolvency is important and remains unsettled. The introduction of the restructuring plan, which because of its financial threshold condition sits closer to traditional insolvency mechanisms than other debt restructuring mechanisms at least in its timing, has added to the difficulties. One of the difficulties is that bankruptcy exceptions such as that in the Lugano Convention are predicated on an idea of traditional insolvency which is largely at odds with a restructuring, and yet the language used is potentially broad enough to bring within it some restructuring mechanisms. In determining whether a restructuring mechanism should be regarded as an insolvency procedure, a better starting point would be a functional approach based on the purpose of the provision.

In relation to the bankruptcy exclusion within the Lugano Convention, for example, the underlying rationale is said to be that the "peculiarities" of bankruptcy requires special rules.[107] Perhaps the principal peculiarity of insolvency proceedings is that they are a collective process, driven by the need to solve the common pool problem. The collective nature of insolvency proceedings means that the approach to questions of jurisdiction and recognition is shaped by the principle of universalism, whereby "[t]here should be a unitary bankruptcy proceeding in the court of the bankrupt's domicile which receives world-wide recognition and it should apply universally to all the bankrupt's assets",[108] or, more accurately, modified universalism which allows exceptions in certain circumstances. This approach regards the objectives of insolvency law as being best served by a unitary insolvency process. The Lugano Convention provides various bases whereby a court may assume jurisdiction by reference either to a person's place of domicile or the nature of the claim made against them. The aim of the bankruptcy exception in the Convention is therefore to avoid establishing a multiplicity of jurisdictions having oversight of the process because of the differing locations of creditors and the differing attributes of their claims. Arguably however, reorganisations have more in common with civil and commercial matters more generally (outside bankruptcy), which under the Lugano Convention are treated more broadly, without the attachment to universalism. As discussed, debt restructuring has a different rationale from insolvency proceedings, being a contractual arrangement between the parties with court oversight and sanction, rather than a debt collection exercise. Restructurings are not collective in the way that traditional insolvency proceedings are, and the issue to be addressed is predominantly that of anticommons. While insolvency proceedings have an inevitable debtor-focus,

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[107] See Report by Mr P. Jenard on the Convention of 27 September 1968 on jurisdiction and the enforcement of judgments in civil and commercial matters, 5 March 1979 (the "Jenard Report"), 11; Official Explanatory Report on the Lugano Convention by Professor Fausto Pocar, 2009/C 319/01, para. 10.

[108] *Re HIH Casualty and General Insurance Ltd* [2008] UKHL 21; [2008] 1 W.L.R. 852 at [6] per Lord Hoffmann.

since the fundamental purpose of the proceedings is the debtor's insolvency, the focus of restructuring is on the creation of the new inter-creditor bargain. The judge in *Gategroup* focused on the timing of restructuring plans to argue that the process involved was akin to insolvency proceedings for this purpose.[109] Arguably, however, the focus should instead be on the purpose of the proposed resolution of the company's distress. If the purpose is a reorganisation of the company's capital by existing creditors to reflect a new bargain rather than a sale and distribution, this is arguably closer to civil and commercial matters more generally than to insolvency concerns.[110]

VI. The impact on cross-border reorganisations

The next impact of the developments discussed in part II is on cross-border reorganisations. When the English courts determine whether to sanction a scheme of arrangement or a restructuring plan involving a foreign company, they consider whether the mechanism will be given legal effect elsewhere in the world, and particularly where the company's creditors are located. Without recognition of the scheme or restructuring plan in those jurisdictions, a dissentient creditor could seek to initiate a separate insolvency or restructuring process in another jurisdiction which could conflict with the English process. As discussed in part II, one effect of Brexit has been to deplete the options for recognition where the company in question has creditors in EU Member States, due to fact that the Recast Judgments Regulation no longer applies in the UK.[111] As a result other means of recognition need to be relied upon if such companies are to utilise a UK scheme or restructuring plan.

The UK Government has therefore sought other avenues for facilitating the recognition of English judgments in EU Member States post-Brexit. First, the UK submitted its application to accede to the 2007 Lugano Convention. The UK was previously a member of the Lugano Convention as a member of the EU rather than in its own right and therefore its membership came to an end on 1 January 2021. Two significant difficulties arise regarding the likelihood that the Lugano Convention will be beneficial as a means of recognition for reorganisations. First, the UK's accession to this Convention requires the unanimous agreement of the contracting parties, namely the EU, Denmark (as an independent state), Iceland, Norway and Switzerland; to date the EU's agreement has been unforthcoming. Second, even if this political hurdle is surmounted, there is the significant question of the utility of the Lugano Convention in this regard which was discussed in part V.

Another option for recognition rests on the Hague Convention of 30 June 2005 on choice of court agreements.[112] As with the Lugano Convention, the UK was previously a party to this Convention as a result of its membership of the EU. After leaving the EU the UK needed to accede to this Convention in its own right, but politically the process was simpler as the UK did not need the agreement of the

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109 [2021] EWHC 304 (Ch) at [102].

110 I. Merovach and A. Walters, "The Characterization of Pre-Insolvency Proceedings in Private International Law" [2020] E.B.O.R. 855.

111 For countries outside the EU, the options for recognition are unaffected by Brexit. See J. Payne, *Schemes of Arrangement: Theory, Structure and Operation*, 2nd edn (Cambridge: Cambridge University Press, 2021), ch. 7.

112 A longer term option might be the 2019 Hague Convention, which is much broader in scope than the 2005 Hague Convention and is not limited to judgments arising from exclusive jurisdiction clauses. The EU Commission has proposed that the EU should join this Convention. At this stage, however, widespread ratification of the 2019 Convention is a long way off.

EU to do so. Where the Hague Convention applies, English judgments will be enforceable in the EU and in the other Hague Convention contracting states, currently Mexico, Montenegro and Singapore. However, there are various limitations to this option. The Hague Convention only applies where there is an exclusive jurisdiction clause which was entered into after the Convention came into force for the chosen state.[113] The Hague Convention also contains a bankruptcy exception in broadly the same terms as that contained in the Lugano Convention. As a result, the *Gategroup* judgment could also limit the use of the Hague Convention for matters involving restructuring plans, although this has not yet been tested. If restructuring plans were to fall within the bankruptcy exclusion in the Hague Convention, it would not be possible to rely on this Convention to achieve international recognition and enforcement of a judgment relating to a restructuring plan.

Given these difficulties with the applicability of the Lugano and Hague Conventions, other mechanisms need to be developed for the recognition of reorganisations. One option is recognition under private international law principles. Domestic conflicts of laws rules in other jurisdictions may provide rules for the discharge or variation of obligations.[114] Foreign jurisdictions will often allow foreign law contractual obligations to be modified by foreign law proceedings such as schemes of arrangement.[115] However, recognition on this basis can be subject to local law issues and public policy considerations and this can introduce an element of uncertainty. A second means of recognition is under the Rome I Regulation.[116] Following Brexit, this Regulation has also ceased to have direct effect in the UK. However, this does not affect its application in remaining EU Member States. The Rome I Regulation contemplates that the expressed governing law of a contract (and that could be any governing law in theory whether of an EU Member State or otherwise) is the right law to handle the extinguishment of rights under the contract. Some debate exists however as to whether schemes of arrangement (and by extension restructuring plans) fall within the scope of this Regulation, since certain matters are excluded from its ambit, including questions governed by the law of companies.[117] The preferable view is that this exclusion is aimed predominantly at corporate governance issues rather than matters concerning the life and death of the company and there is some support for the view that schemes of arrangement at least are capable of being recognised and enforced under this provision;[118] the position has not yet been tested in relation to restructuring plans.

Consequently, there is some uncertainty about the extent of the English court's jurisdiction to sanction reorganisations of foreign companies involving creditors based in EU Member States. The likely effect of Brexit plus the *Gategroup* decision is to limit the recognition of restructuring plans in other jurisdictions, thus diminishing their marketability as a cross-border restructuring tool.

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[113] The requirement of an exclusive jurisdiction clause is therefore more restrictive than that applied in relation to the Recast Judgments Regulation. There is also a division of opinion between the UK and the EU regarding when the Convention should be treated as having entered into force in the UK, with the UK taking the view that the Hague Convention should be treated as having been in force for the UK since 1 October 2015, when it came into force for the EU generally, whereas the view of the European Commission is that the date should be from when the UK re-joined on 1 January 2021.

[114] See *Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* (1890) 25 Q.B.D. 399.

[115] E.g. *Re NEF Telecom Company BV* [2012] EWHC 2944 (Comm); [2014] B.C.C. 417.

[116] Regulation (EC) No 593/2008.

[117] Article 1(2)(f).

[118] E.g. *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch); *Re Metroveacesa SA* [2011] EWHC 1014 (Ch).

Transitional effects

These issues are clearly still at an early stage of development by the courts. Numerous questions exist regarding the applicability of the Lugano Convention, the Hague Convention and the Rome I Convention to restructuring plans and schemes of arrangement. These issues will take time to determine and it is not clear that the preferable view put forward in this article, namely that neither restructuring plans not schemes should be regarded as insolvency procedures, will prevail. In the meantime there will be a considerable period of uncertainty for debtors and creditors. One possible effect for debtors wishing to make use of English debt restructuring tools is to force them to make an undesirable choice between the greater international recognition that a scheme of arrangement may afford and the benefits of a cross-class cram down offered by a restructuring plan. For companies less concerned about making use of the English jurisdiction, this may prompt them to look to the other debt restructuring options available internationally.

VII. Conclusion

The developments introduced to UK debt restructuring via CIGA have been the most significant changes in a generation. The combination of these new restructuring tools and the consequences of the UK's exit from the EU has meant that UK debt restructuring is entering a new phase. These developments operate to create both opportunities and challenges for commercial parties. The triumvirate of restructuring plans, the restructuring moratorium and constraints on *ipso facto* clauses has given debtors powerful new tools to deal with their financial difficulties, and to help them come to a new arrangement with their existing creditors about their future relationship. Yet, debtors face various potential difficulties. If the balance shifts too far pro-debtor then adjusting creditors will seek to renegotiate their terms and price, or may even take their business elsewhere; the modular nature of these changes also creates incentives for creditors to renegotiate their relationships with debtors, or may change their behaviour when faced with distress in ways which benefit the creditors but may be disadvantageous to the ultimate goal of the debtor's rescue. Foreign debtors may also find that their choice of UK restructuring mechanisms is not straightforward, a situation which is exacerbated by the UK's exit from the EU where that foreign company involves creditors in EU Member States. Adjusting creditors may wish to reconsider their willingness to lend and the terms of their lending in the light of both the new debtor-friendly regime and the modular nature of the UK's provisions, which provide opportunities for creditors to advantage themselves even though this may be contrary to the overall rescue-oriented goal of the provisions. These developments also have potential implications for the UK more broadly as both debtors and creditors may have a choice of jurisdictions in which to operate. The combined effects of the changes discussed in this paper have the potential to weaken the attractiveness of the UK debt restructuring regime for both domestic and foreign companies. Regulatory competition was one of the drivers of these changes and it is also likely to play a significant part in determining whether they are ultimately regarded as a success.

The precise extent of these changes has yet to emerge. One of the significant difficulties created by the current transitional phase is the lack of commercial certainty for the parties. This will take time to resolve given that so much of the law-making in this area is left to the judges. It is the courts that must determine the meaning of terms such as the "relevant alternative" in restructuring plans and must construct mechanisms for determining whether the restructuring surplus has been appropriately distributed. Similarly in relation to the restructuring moratorium and *ipso facto* provisions, the extent of the creditor's ability to contest these provisions is largely left to the courts to develop. In this way it is the courts that will provide clarity on the nature of the balance between the parties. The early signs are encouraging, but there is some way to go yet. It is the courts that will also have to determine the boundary between insolvency and restructuring, and to determine the availability of the UK mechanisms for foreign companies via their decisions about the likely recognition of these mechanisms elsewhere in the world. Here the signs are more mixed. Although the new restructuring tools borrow from insolvency mechanisms, it is important to keep separate the purpose of these two devices. Only then will it be possible to navigate effectively through this transitional period.