Debt restructurings, debt grifting and the limits of contractualism

This paper critically examines corporate restructuring plans and schemes in the UK and US and third party releases in the context of such corporate restructurings. So far, the practice has been more extensively examined in the US rather than the UK and the practice has been castigated as 'debt grifting' i.e. third parties getting the benefit of a bankruptcy discharge without going through the formal bankruptcy process. The paper acknowledges some of these criticisms. It also suggests that if third party releases becomes more widespread in the UK, this is likely to militate against the success of the UK as an international corporate restructuring venue. This is particularly the case if the underlying debt is disputed or gives rise to social or political controversy.

The paper is divided into five parts. After a first introductory part, the second part will examine how debts are restructured in the large corporate context in the UK and how third party releases are important for this endeavour. The third part will examine the equivalent position in the US. The fourth section explores how the restructuring solutions currently on the table push up against the limits of contractually derived solutions. The final section concludes.

1. Introduction – the UK and international debt restructurings

It is a trite proposition that a company, even a company within a group of companies, is a separate legal person with rights and liabilities peculiar to itself. It is equally trite to say that a company may be a member of a group of companies and that international business is invariably conducted through a corporate group structure. There may be a network of parent and subsidiary companies. Borrowing on behalf of the group as a whole may be done through a separate financial arm with funds then passed on to other companies within the group.[1] Viewed from a business angle, everything is done on a group basis. Individual companies enter separate insolvency proceedings and there is no legal concept of group insolvency proceedings though in practice the solvency of the corporate group as a whole may be intertwined.[2] The insolvency, or lack of solvency, of one group member may impact on the solvency on other members of the corporate group. Legal practice is formally different. If one

[1] See generally R Squire, 'Strategic Liability in the Corporate Group', 78 U Chi L Rev 605; H Hansmann & R Squire, 'External and Internal Asset Partitioning: Corporations and their Subsidiaries,*'* in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (J Gordon & W Ringe, eds) (Oxford, OUP 2018).

[2] See generally S Paterson, 'Rethinking Corporate Bankruptcy Theory in the Twenty-First Century' (2016) 36 *Oxford Journal of Legal Studies* 697.

of the weakest subsidiaries falls into insolvency, the parent company and the other subsidiary companies may prosper to the befit of its shareholders unencumbered by the liabilities of the insolvent subsidiary.

Templeman LJ put the point colourfully in *Re Southard & Co Ltd*[3] when he said:

'English company law possesses some curious features, which may generate curious results. A parent company may spawn a number of subsidiary companies, all controlled directly or indirectly by the shareholders of the parent company. If one of the subsidiary companies, to change the metaphor, turns out to be the runt of the litter and declines into insolvency to the dismay of its creditors, the parent company and the other subsidiary companies may prosper to the joy of the shareholders without any liability for the debts of the insolvent subsidiary.'

It is not simply English law that has these essential features. European insolvency law also contains a single company focus. Under Regulation 2015/848 main insolvency proceedings in respect of a debtor company with its centre of main interests (COMI) with the European Union (EU) should be commenced in the EU country where the debtor has its centre of main interests.[4] The focus is on the individual debtor or debtor company. It does not matter for this purpose where other companies within the group or the group as a whole may have its centre of main interests.[5]

One of the ostensible objectives of the EU Insolvency Regulation is to prevent 'forum shopping' i.e. the movement of assets or persons from one jurisdiction to another so as to take advantage of a more favourable legal position.[6] The 'recast' Regulation – Regulation 2015/848 – implicitly draws a distinction between good and bad forum shopping. Improving the restructuring possibilities for the group as a whole may be seen as an example of good forum shopping while prejudicing the positon of some creditors so as to advantage other creditors may be seen as bad forum shopping forum.

In many domains of law, the UK is seen as a good forum shopping venue, both for the legal products on offer and for the quality of the service provided by legal professionals and the judiciary.[7] The same is true of the restructuring and insolvency spheres. One of the perceived advantages of UK law lies in the restructuring opportunities it offers for corporate group debt

[3] [1979] 1 WLR 1198 (CA) 1208 at 1218.
[4] Article 3(1). It is stated that the 'centre of main interests shall be the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties.'
[5] *Eurofood IFSC Ltd* [2006] ECR *I-03813*.
[6] Recital 5.
[7] On 'forum shopping' under the Insolvency Regulation see M Szydlo, 'Prevention of Forum Shopping in European Insolvency Law' (2010) 11 EBOR 253; WG Ringe, 'Forum Shopping under the EU Insolvency Regulation' (2008) 9 EBOR 579; G McCormack, 'Jurisdictional Competition and Forum Shopping in Insolvency Proceedings' (2009) 68 CLJ 169.

as a whole. While there is no formal restructuring mechanism for group debt, still less for group debt within European or wider international legal structures, the flexibility of the English common law appears to provide imaginative solutions through co-obligor/guarantor liability and third party debt discharge or releases.[8] But there may be limits to contractualism and contractually derived solutions.[9]

It became necessary to expand the ambit of the UK Scheme of Arrangement procedure with the addition of so-called 'super schemes' or 'restructuring plans' in the Corporate Insolvency and Governance Act 2020[10] and it may become necessary for statute to specify the limits to which third party releases may extend. This time has however, not yet come. In the US there are provisions that pronounce on the limits of third party releases though in a somewhat indirect and indecisive fashion. At the moment, it may be that the UK offers advantages over the US as a forum shopping venue in respect of debt restructurings and third party releases.[11]It is questionable however whether such advantages can continue.

2. Debt restructuring in the large corporate context in the UK

In the past decade or more, debts for large corporates have been restructured by means of schemes of arrangement.[12] The UK scheme of arrangement under Part 26 Companies Act 2006 has also been spoken of as a model for the 'early stage' restructuring procedure.[13] It has been suggested that a procedure modelled on the UK scheme would make restructuring procedures less cumbersome, less costly and speedier than they are currently in some EU States'.[14]

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[8] See the recent Adler Group restructuring - *Re AGPS Bondco Plc* [2023] EWHC 916 (Ch).

[9] And also limits to restructuring law – see H Eidenmüller, 'What Can Restructuring Laws Do? Geopol(itical Shocks, the New German Restructuring Regime, and the Limits of Restructuring Laws' (2023) 24 EBOR 231-249.

[10] See generally K van Zwieten, 'Mid-Crisis Restructuring Law Reform in the United Kingdom' (2023) 24 EBOR 287-315.

[11] See I Kokorin 'Third-Party Releases in Insolvency of Multinational Enterprise Groups' (2021) 18 *European Company and Financial Law Review* 107.

[12] See generally N Stolowy, 'Insolvency and Brexit, an example of forum shopping in business law' [2023] JBL 99; E Vaccario, 'WHOA, Brexit! What future for London as Europe's (largest) insolvency forum?' (2022) 37 JIBLR 46.

[13] See S Madaus, 'The EU Recommendation on Business Rescue: Only Another Statement or a Cause for Legislative Action across Europe?' [2014] *Insolvency Intelligence* 81 at 84. see generally H Eidenmüller, 'Comparative Corporate Insolvency Law' in J Gordon and W Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (Oxford, OUP, 2018) ch 38; 'The Rise and Fall of Regulatory Competition in Corporate Insolvency Law in the European Union' (2019) 20 EBOR 547.

[14] Recommendation Impact Assessment SWD (2014) 61 at p 38. The impact assessment also references UK company voluntary arrangements (CVAs) at pp 15–16 though the reference does not acknowledge that most CVAs take place during the course of the administration procedure. There is now an EU preventive Restructuring Directive 2019/1023.

Certainly, the scheme of arrangement procedure has some positive features. It does not have any bankruptcy or insolvency stigma for it is a procedure based on company law rather than insolvency law.[15] It is opened by the filing of documents with the court and an application to the court to convene meetings of relevant creditors and shareholders to approve the scheme though the process is set in train without any court decision as such. The scheme procedure, in fact, may be used for various purposes including as a takeover mechanism in relation to wholly solvent companies. In addition, it may be used within a formal liquidation process to achieve a less costly and more efficient realisation and distribution of assets than the liquidation rules would normally allow.

It may also be used by companies of doubtful solvency to restructure their debts or rearrange their affairs. It has also proved extremely attractive as a restructuring vehicle of choice for companies incorporated outside the UK since the UK courts have jurisdiction to sanction a scheme if the company is deemed to have 'sufficient connection' with the UK irrespective of where it was incorporated.[16] The 'sufficient connection' test has been established in cases like *Re Drax Holdings Ltd*[17] and in *Re Rodenstock GmbH*.[18] A sufficient connection has been deemed to exist by virtue of the fact that the company's credit facilities contain English choice of law and jurisdiction clauses. Expert evidence that the relevant foreign courts would recognise the scheme is also generally required. In practice, a loan facility governed by English law will be enough to pass the sufficient connection test.[19]

In the UK there are also other possible mechanisms available for corporate debt restructuring including a company voluntary arrangement (CVA). Typically, the usage of CVA has been low for various reasons. It is an Insolvency Act procedure (introduced in the Insolvency Act 1986) with an implicit insolvency stigma and, moreover, it does not bind secured or preferential creditors without their consent.[20]

On the other hand, the CVA is quite flexible since creditors are not divided into classes nor does it have to come before the court for approval. It need only come before the court if it is

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[15] Schemes are dealt with in Part 26 Companies Act 2006. See generally C Pilkington and W Stoner, Pilkington on Creditor *Schemes of Arrangement and Restructuring Plans* (3nd ed, London, Sweet & Maxwell 2022); G O'Dea ed *Restructuring Plans, Creditor Schemes and other Restructuring Tools* (Oxford, OUP, 2022); J Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge, CUP, 2nd ed 2021).

[16] See *Re Seat Pagine Gialle SpA [2012] EWHC 3686; Primacom Holdings GmbH v Credit Agricole* [2011] EWHC 3746; *Re Rodenstock GmbH* [2011] EWHC 1104.

[17] [2004] 1 WLR 1049.

[18] [2011] EWHC 1104 (Ch), [2011] Bus LR 1245.
[19] *In Re Magyar Telecom BV* [2013] EWHC 3800 (Ch).
[20] J Payne, 'Debt Restructuring in English Law: Lessons from the United States and the Need for Reform' (2014) 130 LQR 282 at 289.

challenged within tight limits and either on grounds of failure to disclose adequate information or on the basis of unfair prejudice to an interested party.[21]

In recent years, CVAs have become more popular as a restructuring vehicle for businesses in the service sector, particularly in the retail and casual dining sectors and there have been a number of high profile uses of CVAs in this arena.[22] Because of statutory and jurisdictional factors they lack the same appeal, however, for international companies though the scheme procedure has filled this gap.

The UK scheme was once described as somewhat cumbersome[23] but it is now used as a powerful debt restructuring tool, altering in various ways the financial obligations of companies. The matter was considered by Newey J in *Re Codere Finance (UK) Ltd*[24] who made explicit the distinction between 'good' and 'bad' forum shopping. Newey J said:[25]

'Plainly forum shopping can be undesirable. That can potentially be so, for example, where a debtor seeks to move his COMI with a view to taking advantage of a more favourable bankruptcy regime and so escaping his debts. In cases such as the present, however, what is being attempted is to achieve a position where resort can be had to the law of a particular jurisdiction, not in order to evade debts but rather with a view to achieving the best possible outcome for creditors. If in those circumstances it is appropriate to speak of forum shopping at all, it must be on the basis that there can sometimes be good forum shopping.'[26]

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[21] See the high profile challenge in the CVA involving Debenhams Stores – *Discovery (Northampton) Ltd v Debenhams Retail Limited* [2019] EWHC 2441 (Ch). See generally N Cooper, 'The Death of the CVA? Landlord Compromises and the Restructuring Plan' [2020] *International Corporate Rescue* 270.

[22] See https://www.gov.uk/government/publications/company-voluntary-arrangement-cva-research-report-for-the-insolvency-service/company-voluntary-arrangement-research-report-for-the-insolvency-service

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[23] Sir Kenneth Cork, *Insolvency Law and Practice: Report of the Review Committee* (Cmnd 8558, 1982) para 419 and see also The Insolvency Service, *Report of the Joint DTI/Treasury Review of Company Rescue and Business Reconstructions Mechanisms* (London, Department of Trade and Industry, May 2000) para 43.

[24] [2015] EWHC 3778 (Ch). Note too *Re Algeco Scotsman PIK SA* [2017] EWHC 2236 (Ch). Hildyard J commented at para 57 that although 'forum shopping' had been used as a pejorative description of a situation where a company resorted to an inappropriate court for inappropriate purposes, the company's resort to the English court in the present case was appropriate and understandable given the lack of any viable or efficient alternatives. The judge also reiterated that, whenever there is a change in jurisdiction clause for the purpose of opening the gateway to the English scheme jurisdiction, the court should be careful to scrutinise whether the change of law or jurisdiction, or the resort more generally to the English court, was inappropriate.

[25] Para 18.

[26] See more generally S Davydenko and J Franks, 'Do Bankruptcy Codes Matter? A Study of Defaults in France, Germany and the UK' (2008) 63 *Journal of Finance* 565 at pp 603–4 for the statement that many European restructuring frameworks are still inflexible, costly and value destructive.

The scheme provisions are in the UK Companies legislation[27] but the law has also been developed substantially by judicial interpretation. Essentially, the scheme involves an arrangement between a company and its creditors and/or members with some element of 'give and take' on both sides.[28]
The sanctioning of a scheme is a three-stage procedure with, firstly, an application to the court to convene relevant meetings of creditors or members of a company. Secondly, the relevant class meetings are held and the scheme is required to be approved by 75% in value and a majority in number of creditors within each class. The third stage involves the scheme coming before the court for approval.
The court must be satisfied that the scheme proposed is a reasonable one such that a reasonable member of the class concerned and acting in respect of its own interests could have voted for it.[29] The court is not a rubber stamp but it need not be satisfied that the scheme proposed is the only fair one.[30] Thus, the court must be satisfied that the statutory provisions have been observed, the relevant class must have been fairly represented by those who attended the meeting and that the statutory majority were acting bona fide and not coercing the minority in order to promote interests adverse to those of the class they purport to represent.[31] The court addresses whether an intelligent and honest person, a member of the class concerned and acting in respect of its own interest, might reasonably approve the scheme.

While dissenting creditors within a class may be 'crammed down', in schemes under Part 26 Companies Act 2006 there is no scope for dissenting classes of creditors in their entirety to be 'crammed down'. This fact makes the composition of creditor classes very important in the context of a scheme of arrangement. It also leads to more complicated strategies that are devised with a view to 'squeezing out' dissenting creditors. To a certain extent, the courts have aided scheme proponents through their interpretations of the class composition rules. It has

[27] Part 26, Companies Act 2006 (UK).

[28]In *In re NFU Development Trust Ltd* [1972] 1 WLR 1548 Brightman J observed that a compromise implies some element of accommodation on each side and that an arrangement implies some element of give and take. Total surrender or confiscation was not within either of them. In *In re Savoy Hotel Ltd* [1981] Ch 351 at 359 Nourse J said that the word 'arrangement' is one of very wide import. There must be some element of give and take. Beyond that it is neither necessary nor desirable to attempt a definition'.

[29] See *Anglo-Continental Supply Co Ltd* [1922] 2 Ch 723, 736.
[30] It has been pointed out that the test is not whether the opposing creditors have reasonable objections to the scheme since a creditor might be acting equally reasonably in voting either for or against the scheme. In these circumstances, the English courts consider that creditor democracy should prevail: see *Re British Aviation Insurance Co Ltd* [2005] EWHC 1621, [75].
[31] See also Plowman J in *Re National Bank Ltd* [1966] 1 All ER 1006 at 1012, [1966] 1 WLR 819 at 829

been held that questions on class composition should be determined at the convening hearing stage rather than later at the hearing to sanction the scheme.[32]

In addition, the relevant test to work out the constitution of classes is whether creditors have different legal rights rather than separate interests that may stem from these legal rights.[33] It has also been held that small differences in rights do not prevent creditors being placed in the same class.[34] The courts take a 'broad brush' approach to avoid the situation where a minority group of creditors have an effective veto on whether the scheme should be approved.[35] Moreover, it is the case that 'lock-up' agreements – small financial inducements given to creditors who vote in favour of the scheme proposals before a particular date – do not necessarily require that the creditors bound by the lock-up agreement should be put in a separate class.[36]

Moreover, it has been held that it is only necessary to get the consent of those with an economic interest in the proposed restructuring. Schemes might therefore be used to 'squeeze out' creditors who are 'out of the money' as in *Re MyTravel plc*[37] and *Re IMO Carwash*.[38] Such schemes are usually implemented as part of 'pre-packaged' administration and are generally referred to as 'pre-pack' or 'business transfer' schemes.

Business transfer schemes may be complex but they also give rise to questions of fairness and procedural propriety.[39] The courts consider where in the debt structure the value 'breaks'; how one assesses value; and what is the relevant comparator for assessing fairness and value – whether it is liquidation value, going-concern value or something else?[40]

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32 See *Re Telewest Communications plc* [2005] BCC 29.
33 *In re Hellenic & General Trust Ltd* [1976] 1 WLR 123.
34 *Sovereign Life Assurance Co v Dodd* [1892] 2 QB 573 (a scheme class confined to those 'persons whose rights are not so dissimilar to make it impossible for them to consult together with a view to their common interest').
35 See Chadwick LJ in *Re Hawk Insurance Co Ltd* [2001] 2 BCLC 480, [33], suggesting that the relevant tests should not be applied in such a way that they become an instrument of oppression by a minority.
36 See *Re Global Garden Products Italy SpA* [2016] EWHC 1884.
37 See *Re My Travel Group plc* [2004] EWHC 2741 (Ch) and *Re Tea Corp Ltd* [1904] 1 Ch 12. For a general discussion, see CL Seah, 'The Re Tea Corporation Principle and Junior Creditors' Rights to Participate in a Scheme of Arrangement: A View from Singapore' (2011) 20 *International Insolvency Review* 161.
38 This case is also referred to as *Re Bluebrook* [2009] EWHC 2114 (Ch).
39 See generally M Crystal QC and R Mokal, 'The Valuation of Distressed Companies: A Conceptual Framework Parts 1 and 11' (2006) 3 *International Corporate Rescue* 63 and 123; N Segal, 'Schemes of Arrangement and Junior Creditors: Does the US Approach to Valuations Provide the Answer?' (2007) 20 *Insolvency Intelligence* 49.
40 In the UK, the Insolvency Service, *A Review of the Corporate Insolvency Framework: A Consultation on Options for Reform* (May 2016) states at 9.9: 'The cram-down of a rescue plan onto "out of the

Quite apart from the difficulties involving pre-packs, there are, however, a number of other limitations with schemes of arrangement including the lack of a cross-class 'cramdown' facility. The Corporate Insolvency and Governance Act 2020 however, made major changes to the UK's corporate restructuring and insolvency laws inter alia, by introducing a new flexible 'restructuring plan' procedure (Part 26A schemes).

The Part 26A option to implement a restructuring plan may be used 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,

and

a compromise or arrangement is proposed between the company and its creditors, or any class or them, or its members, or any class of them.[41]

The explanatory notes on the legislation suggest that the commonality between the restructuring plan and the scheme of arrangement should allow courts to draw on the existing body of case law where appropriate.[42]Unlike, however, schemes of arrangement under Part 26, a restructuring plan can be approved by the court if there is a 'dissenting class', that is, less than 75% of a particular class of creditors have approved the plan, if the following conditions are met:

- Condition A: The court is satisfied that, if the plan were to be approved, none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative.
- Condition B: The plan has been agreed by at least 75% in value of a class who would receive a payment, or have a genuine economic interest in the company, if the relevant alternative were to occur.

The 'relevant alternative' is whatever the court considers would be most likely to occur in relation to the company if the restructuring plan were not sanctioned by the court.[43] Unlike the

money" creditors is currently possible in the UK only through a costly mix of using a scheme of arrangement and an administration.' The Government believes that developing a more sophisticated restructuring process with the ability to "cram-down" may facilitate more restructurings, and the subsequent survival of the corporate entity as a going concern.'

[41] New s 901A.

[42] House of Lords Explanatory Notes (2020), at https://publications.parliament.uk/pa/bills/lbill/58-01/113/5801113en.pdf at para 16.

[43] See the new s 901G.4 Companies Act 2006.

position for the traditional Part 26 scheme there is no additional numerosity requirement i.e. a majority in number of affected persons.[44]

As in a scheme of arrangement, class classification is a hot topic in any restructuring plan though the dynamics are different in the two contexts. In a Part 26 scheme all classes need to assent whereas a restructuring plan needs only a single assenting class.[45] In a plan, any creditor or member whose rights are affected by the plan must be permitted to participate in the process, but those who have no genuine economic interest in the company may be excluded. Affected members and creditors must be given sufficient information to be able to vote on the plan.[46] A restructuring plan sanctioned by the court is binding on all creditors/members, or the relevant classes of creditors/members, and the company.

The court has a broad general discretion on whether to sanction a plan with no criteria specified in the legislation. Valuation issues are particularly important at the sanction stage including consideration of what is the likely alternative if confirmation is refused,[47] and whether those with a genuine economic interest have been excluded from participation in the process.[48] Part 26A is a new set of provisions intended to achieve outcomes that could not be achieved under Part 26, and the court recognises that.[49] Particularly important is the distribution of the restructuring surplus i.e. the surplus over the 'relevant alternative' produced by the restructuring process.[50]

A scheme or restructuring plan may compromise a creditor's claim against a third party i.e. a person other than the company in respect of whom the scheme or plan is proposed. This may

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[44] On hearings under Part 26 or Part 26A of the CA 2006 see the Practice Statement issued by the Chancellor of the High Court on 26 June 2020.

[45] See *Re Hurricane Energy Plc* [2021] EWHC 1418 (Ch) (convening hearing) and [2021] EWHC 1759 (Ch) (sanction hearing), Zacaroli J.
[46] See the new s 901D Companies Act 2006.
[47] Possibly an alternative plan or a sale of the business rather than a liquidation/administration.
[48] See House of Lords Explanatory Notes (2020) at para 205: 'When determining the "relevant alternative" the court should consider what would be most likely to occur in relation to the company if the restructuring plan were not sanctioned' at https://publications.parliament.uk/pa/bills/lbill/58-01/113/5801113en.pdf.
[49] See R Dicker QC and A Al-Attar, 'Cross-Class Cram Downs' South Square Digest special issue on Corporate Insolvency and Governance Act 2020' 34 at 43 , at https://southsquare.com/wp-content/uploads/2020/07/Digest_Magazine_Mini_Digital-CIGA.pdf. R Mokal. 'The Two Conditions for Part 26A Cram Down" (2020) 11 JIBL 730 and 'The Court's Discretion in Relation to the Pt 26A Cram Down' (2021) 1 JIBL 12).
[50] See *Re Virgin Active Holdings Ltd [*2021] EWHC 1246 (Ch), *Re Houst Ltd* [2022] EWHC 1941 (Ch), *Re Great Annual Savings Co Ltd* [2023] EWHC 1141 (Ch) and Re *Nasmyth Group Ltd* [2023] EWHC 988 (Ch)

be done where such a compromise is ‘necessary in order to give effect to the arrangement proposed for the disposition of the debts and liabilities of the company to its own creditors’.[51]

As Marcus Smith J pointed out in *Re Haya Holco 2 Plc*[52] this principle is commonly invoked in the context of a scheme/plan proposed by a borrower where other group companies have granted guarantees. ‘Thus, if X is the borrower and Y is the guarantor, then X may propose a scheme to release the creditors' claims against both X (as borrower) and Y (as guarantor). Otherwise, the creditors would be entitled to sue Y under the guarantee, and Y would be entitled to claim the entire amount back from X in accordance with the guarantor's right of indemnity’. This "ricochet claim" would defeat the purpose of the scheme, since X would ultimately remain liable for the very amount that was purportedly released by the scheme.’

Snowden J in *Re Noble Group Ltd*[53] also made reference to the situation where a scheme compromises debts which are guaranteed and in the absence of such a release, pursuit of the guarantor by a scheme creditor would undermine the compromise between the creditor and the company.[54] Mention could also made in this connection to other cases such as *Re APCOA Parking Holdings GmbH*,[55] *Re Lecta Paper UK Ltd*[56] and *Re Codere Finance 2 (UK) Ltd*[57].In both *Re Lecta* and *Re Codere*, the scheme was proposed by a company which had recently acceded to the relevant bond debts as a co-issuer (and the same was true in *Re Haya Holco 2 Plc*). A similar structure was adopted and approved by the court in the restructuring plan case - *Re Gategroup Guarantee Ltd.*[58]

In short, the scheme or plan releases debt obligations incurred by parties other than those who made the application to the court. How can this be right? It calls into question the limits of contractualism. Certainly there is not direct statutory authority for the practice. The same is true about the US. In the US, the courts have been somewhat equivocal about third party releases and have proposed limits to map out some boundaries for the discretion of the courts. The US position will now be examined.

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[51] See *Re Lehman Brothers International (Europe) (No 2)* [2010] Bus LR 489 at [65] per Patten LJ; *Re T&N Ltd* [2007] Bus LR 1411 at [53] per David Richards J; *Re La Seda de Barcelona* [2010] EWHC 1364 (Ch) at [20]-[22] per Proudman J; and *Re Magyar Telecom BV* [2014] BCC 448 at [33].

[52] [2022] EWHC 1079 (Ch).

[53] [2019] BCC 349 at [24] (sanction judgment)
[54] See also *Re Lehman Brothers International (Europe) (No 2)* [2009] EWCA Civ 1161; [2010] Bus LR 489; [2010] BCC 272 at [65] (Patten LJ).
[55] [2015] Bus LR 374 at [149] per Hildyard J
[56] [2020] EWHC 382 (Ch) at [21] per Trower J
[57] [2020] EWHC 2441 (Ch) at [138] per Falk J
[58] [2021] BCC 549 at [163] per Zacaroli J.

3. Debt restructurings under Chapter 11 of the US Bankruptcy Code

The main internationally known corporate restructuring vehicle in the US is Chapter 11 of the US Bankruptcy Code. According to the courts, the objective of Chapter 11 is 'to provide a debtor with the legal protection necessary to give it the opportunity to reorganize, and thereby to provide creditors with going-concern value rather than the possibility of a more meagre satisfaction of outstanding debts through liquidation'.[59]

It has been suggested that Chapter 11 deserves a prominent place in 'the pantheon of extraordinary laws that have shaped the American economy and society and then echoed throughout the world'.[60] Chapter 11 has been hailed in enthusiastic terms by its supporters and as the model to which restructuring laws across the globe should aspire. [61]

In general, the main features of Chapter 11 are that the management of the company is not displaced in favour of an outside insolvency practitioner. The management itself can prepare a restructuring plan and submit the plan to the creditors. An officer may be appointed to monitor the debtor during the rehabilitation process, but the officer's powers are not as far-reaching as those under a management-displacement regime. A moratorium exists to protect the company from its creditors.[62] There is also a mechanism for the approval of a restructuring plan including 'cram-down' provisions under which a class of creditors, including secured creditors, can be forced to accept a restructuring plan against their wishes. This is the case if the court determines that there is at least one class of creditors who have accepted the plan and also if the court is of the view that the restructuring plan is feasible. There is provision for debtor-in-possession financing under which the company can obtain new funds either to continue its operations or to further the restructuring process. The providers of these new funds may enjoy 'super-priority' ahead of other creditors if existing creditors are deemed by the court to be adequately protected.

Chapter 11 in something like its present form became part of the US Bankruptcy Code in 1978 though there were earlier precedents.[63] Since then Chapter 11 has undergone a mini metamorphosis with now much more of a market orientation to the process. There is a greater

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[59] *Canadian Pacific Forest Products Ltd v JD Irving Ltd* (1995) 66 F 3d 1436 at 1442.

[60] See E Warren and JL Westbrook, 'The Success of Chapter 11: A Challenge to the Critics' (2009) 107 *Michigan Law Review* 603 at 604.

[61] In a leading study by inter alia the Association of Financial Markets in Europe (AFME) and Frontier Economics it has been described as an important comparison point for further insolvency law reform in Europe: AFME, Frontier Economics and Weil, Gotshal and Manges LLP, *Potential Economic Gains from Reforming Insolvency Law in Europe* (February 2016) at p 12.

[62] The US Chapter 11 moratorium or automatic stay as it is called, is automatic in its effects and global in its reach On the worldwide effect of the US automatic stay see *In re Nortel Networks Inc* (2011) 669 F3d 128.

[63] See generally DA Skeel Jr, *Debt's Dominion: A History of Bankruptcy Law in America* (Princeton, Princeton University Press 2001).

emphasis on whole or partial sale of the business assets on a going-concern basis rather than creditors and shareholders coming together under the umbrella of Chapter 11 and working out a restructuring plan. Although the figures are disputed, it has been estimated that 'roughly two-thirds of all large bankruptcy outcomes involve a sale of the firm, rather than a traditional negotiated reorganization in which debt is converted to equity through the reorganization plan'.[64]

Part of the difficulties in working out statistics is that a company may undergo dramatic changes during the Chapter 11 process. Outcomes are often imprecise, difficult to measure and may be assigned potentially to more than one category. 'Companies may shrink in size, be split into multiple businesses, sell their businesses to new owners, discharge their managers, change their names, and fundamentally change the nature of their businesses. One or more businesses may survive after a bankruptcy, but it may nevertheless be difficult to say whether that survivor is the bankrupt company, a company that acquired the bankrupt company, or a company that acquired elements of the bankrupt company.'[65]

Certainly, the business and financing landscape has also changed fundamentally since Chapter 11 was enacted, with the growth of new funding techniques. There has been more expanded use of secured credit, growth in distressed-debt markets as well as other factors that have impacted on the effectiveness of the current law.[66]

Early stage business restructuring including the resolution of mass tort litigation against a debtor company is possible under the US Chapter 11.[67] In the US, a typical Chapter 11 case begins when the debtor company voluntarily files a petition with a bankruptcy court. The petition has to be accompanied by a list of creditors and also a summary of the debtor's assets and liabilities.

Technically, there is no requirement that the company should be 'insolvent' and so-called strategic bankruptcies are a conspicuous part of the US scene. For instance, a company may be faced with large potential tort liabilities and attempts to reach a global settlement with

[64] See K Ayotte and D Skeel, 'Bankruptcy or Bailouts' (2010) 35 *Journal of Corporate Law* 469 at 477. But for another perspective on the available data see Lynn M LoPucki and Joseph W Doherty, 'Bankruptcy Survival' (2015) 62 *UCLA Law Review* 970.

[65] See Lynn M LoPucki and J Doherty, 'Bankruptcy Survival' (2015) 62 *UCLA Law Review* 970 at p 979.

[66] See E Altman, 'The Role of Distressed Debt Markets, Hedge Funds and Recent Trends in Bankruptcy on the Outcomes of Chapter 11 Reorganizations' (2014) 22 *American Bankruptcy Institute Law Review 75*.

[67] See generally TH Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge Ma, Harvard University Press 1986) at pp 1–19 who sees bankruptcy as addressing a collective action problem, an 'over-fishing' or 'tragedy of the commons' problem as it were. See also H Eidenmüller, 'What Is an Insolvency Proceeding?' (2018) 92 *American Bankruptcy Law Journal* 53; S Paterson, 'Rethinking the Role of the Law of Corporate Distress in the Twenty-First Century' (2015) 35 *Oxford Journal of Legal Studies* 1; S Madaus, 'Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law' (2018) 19 EBOR 615; N Tollenaar, *Pre-Insolvency Proceedings: A Normative Foundation and Framework* (Oxford, OUP, 2019).

plaintiffs have broken down. Well-publicised examples of this include the *Johns-Manville* case involving asbestos-related liabilities where the court stated that a business foreseeing insolvency was not required to wait until actual inability to pay debts before entering Chapter 11.[68] Another example concerns the reorganisation of the AH Robins Company brought about by its liability to women who suffered injury as a result of using the Dalkon Shield birth control device.[69]

During the period of Chapter 11 protection, creditors are embargoed from prosecuting their claims and the debtor is provided with an opportunity to work out a structured settlement plan. The primary objective of Chapter 11 is to try to rescue companies that are in serious financial difficulties but the scope for reorganisation under Chapter 11 has been made use of for many purposes such as to settle legal judgments or mass tort liability claims. Commentators point out that[70] 'solvent firms have filed for Chapter 11 bankruptcy to take advantage of the considerable powers incumbent managers have to remake the corporation, undo its commitments, and reduce its obligations . . . In many cases, the reorganizing firm was not insolvent, and may in fact have been performing rather well.'

Applications for Chapter 11 relief must, however, be made in 'good faith'. This means that the application must have been filed with the intention of achieving a corporate restructuring or to bring about a liquidation or sale of the company. If this is not the case, then creditors may apply to have the Chapter 11 petitions dismissed. *SGL Carbon Corporation*[71] is a case in point where a Chapter 11 petition was dismissed on the basis that the company had failed to manifest a genuine 'reorganizational purpose'.

In the US, debtors obtain a discharge of their liabilities upon the confirmation of a restructuring or reorganisation plan as it is called in the US. Section 1114(c) US Bankruptcy Code provides that the 'property dealt with by the plan is free and clear of all claims and interests of creditors, equity holders, and of general partners in the debtor'.

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[68] (1984) 36 Bankruptcy Rep 727.

[69] For an account of this case see Richard B Sobol, *Bending the Law: The Story of the Dalkon Shield Bankruptcy* (Chicago, University of Chicago Press 1991) and see his comment at p 326: 'Bankruptcy is the appropriate response when a business is unable, or can foresee that it will be unable, to pay the cost of mass tort liability. Novel and difficult questions are presented when the liabilities of a financially distressed business arise primarily out of personal injury claims, but no other mechanism is available and, with due regard for the exceptional context, these questions must be addressed and resolved within the bankruptcy system.'

[70] B Carruthers and T Halliday, *Rescuing Business: The Making of Corporate Bankruptcy Law in England and the United States* (Oxford, Clarendon Press 1998) at p 266.

[71] (1999) 200 F 3d 154.

Debtors get a discharge of their liabilities but section 524(e) states that the discharge 'does not affect the liability of any other entity on, or the property of any other entity for such 'pre-confirmation' debt. Nevertheless, US plans sometimes provide for 'third party releases'. It is not uncommon for plans also to stipulate that third parties including directors, new investors and their respective professional advisers are also released from liability.[72]

A third party or non-debtor release refers to a release that is given to a non-debtor party that prevents that released party from being sued by creditors of the debtor. A third party release may be voluntary or involuntary with involuntary third party releases releasing a non-debtor without consent of the creditors. Third party releases may be used to facilitate a settlement between a debtor and its stakeholders by preventing certain claims from being asserted against the released parties after confirmation of the debtor's reorganisation plan.

The permissibility of such releases and whether the releases bind non-consenting creditors has been the subject of conflicting case law. There has been a split between different Circuits and different Circuit Courts of Appeal.[73] Ultimately it will require a decision of the US Supreme Court to provide a resolution of the issue. Until the Supreme Court weighs in, the permissibility of third party releases may depend on the scope of the release, the adequacy of the consideration, and the circuit in which the Chapter 11 bankruptcy case is pending.

Third-party releases can be an effective tool to maximize value in complex chapter 11 cases. For example, they can facilitate and incentivize substantial contributions to the bankruptcy estate that benefit a debtor's creditors and drive valuable settlements without the cost or delay attendant to potentially catastrophic litigation. [74] Non-consensual third-party releases have attracted public attention for their use in the mass tort context where express consent is impossible or at least impractical.[75]

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[72] See generally JL Schroeder and DG Carlson 'Third Party Releases Under the Bankruptcy Code After *Purdue Pharma' (2023)* 31 AM BANKR INST L REV 1.

[73] See the analyses by Judge Robert Drain in *In re Purdue Pharma, LLC* (2021) 633 BR 53 (Bankr SDNY) and by Judge Colleen McMahon on appeal (2021) 635 BR 26 when the first instance decision was reversed.

[74] *See, e.g.*, *In re Drexel Burnham Lambert Group, Inc.,* 960 F.2d 285, 292 (2d Cir. 1992) ('The Settlement Agreement [containing a third party injunction] is unquestionably an essential element of [the debtor's] ultimate reorganization.'

[75] *See* Jan Hoffman, '*Purdue Pharma Is Dissolved and Sacklers Pay $4.5 Billion to Settle Opioid Claims'* THE NEW YORK TIMES (Sept 1, 2021), https://www.nytimes.com/2021/09/01/health/purdue-sacklers-opioids-settlement.html; Jonathan Randles, '*Purdue Pharma Bankruptcy Plan Approved, Freeing Sacklers From Lawsuits'* THE WALL STREET JOURNAL (Sept 1, 2021), https://www.wsj.com/articles/purdue-pharma-bankruptcy-plan-approved-freeing-owners-from-lawsuits-11630528636; Tom Hals & Mike Spector, '*Judge will approve Purdue Pharma bankruptcy plan that shields Sacklers'* REUTERS (Sept 1, 2021), https://www.reuters.com/business/healthcare-pharmaceuticals/judge-rule-purdue-pharma-bankruptcy-plan-that-shields-sacklers-2021-09-01/.

The US Bankruptcy Code does not expressly authorise non-consensual releases outside of asbestos cases but neither does it expressly prohibit them. Apart from s 524(g) which specifically allows third-party releases of parties co-liable with the debtor for derivative asbestos-related claims[76] there are also the general powers of s 105(a) which preserves the equitable jurisdiction of the court in bankruptcy cases as well as other more particular provisions.

In the *Dow Corning Corporation* case[77] seven elements were enumerated for courts to consider in determining whether to approve third-party releases. These encompass whether: (1) there is an identity of interests between the debtor and the third party; (ii) the nondebtor has contributed substantial assets to the reorganization; (iii) the injunction is essential to reorganization; (iv) the impacted class, or classes, has overwhelmingly voted to accept the plan; (v) the plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (vi) the plan provides an opportunity for those claimants who choose not to settle to recover in full; and (vii) the bankruptcy court made specific factual findings.

In another leading case - *Master Mortgage*[78] -, the court also embraced a permissive view of third-party releases and several factors considered by the courts previously were pulled together. The five non-exhaustive *Master Mortgage* factors include whether: (1) there is an identity of interest between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete assets of the estate; (2) the non-debtor has contributed substantial assets to the reorganization; (3) the release is essential to reorganization. Without it, there is little likelihood of success; (4) a substantial majority of the creditors agree to such release, specifically, the impacted class, or classes, has overwhelmingly voted to accept the proposed plan treatment; (5) the plan provides a mechanism for the payment of all, or substantially all, of the claims of the class or classes affected by the release.

In another significant recent case,[79] it was held that the bankruptcy court had constitutional authority to approve a Chapter 11 plan containing nonconsensual third-party releases. The court however limited its decision to the facts before it. It emphasised the intensive

[76] In particular, a section 524(g) injunction may preclude actions against third parties having certain connections with the debtor, including financial interests in the debtor or its affiliates, involvement in the debtor's management, or involvement in a transaction affecting the corporate structure or financial condition of the debtor or its affiliates - see s 524(g)(4)(A)(ii).

[77] *In re Dow Corning Corp* (2002) 280 F 3d 648.

[78] (1994) 168 BR 930, 935 (Bankr WD Mo)

[79] *In re Millennium Lab Holdings II, LLC*, 945 F3d 126 (3d Cir 2019)

negotiations between sophisticated parties, the fact that the releases were 'absolutely required' for the reorganisation, and that the debtor would have gone into liquidation without the releases. The court further emphasized that previous precedents still apply and these require that, to be approved, such releases have the 'hallmarks of . . . fairness, necessity to the reorganization, and specific factual findings to support these conclusions'.

One of the influential actors in the US bankruptcy reform process – the American Bankruptcy Institute (ABI) – produced a comprehensive report in 2014[80] detailing a proposed list of changes to Chapter 11. The reforms were proposed with a view to achieving a better balance between the effective restructuring of business debtors, the preservation and expansion of employment, and the maximisation of asset values for the benefit of all creditors and stakeholders.[81] The nature of the political process in the US however, is such that that these changes are unlikely to be enacted in the very near future.[82]
The ABI Commission Report proposed that non-consensual third-party releases be deemed enforceable, subject to the balancing of five factors. These factors consisted of (i) the identity of interests between the debtor and the third party, (ii) the value contributed by the third party; (iii) the necessity of the release to facilitating the plan of reorganization; (iv) creditor support for the plan; and (v) the payments and protections otherwise available to creditors affected by the release.[83]

The Commission took the view that a blanket prohibition on third-party releases was inadvisable but that third-party releases might not be appropriate in every chapter 11 case. For example, a release provision could be overly broad or unnecessary, particularly in cases where the benefits of the release to the estate are nominal, but the harm to creditors is significant. It rejected carte blanche approval of third-party releases, as well as a presumption in favour of such releases.[84] It discussed the competing considerations. A debtor may need the assistance of non-debtor parties to effect its reorganization and this may take the form of service, collaboration, funding, business commitments, or other means that facilitate the debtor in its post-confirmation operations.

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[80] American Bankruptcy Institute (ABI) Commission to Study the Reform of Chapter 11, *Full Report* (2014), accessed at www.commission.abi.org/full-report.
[81] For detailed criticism of the report by the Loan Syndications and Trading Association (LSTA) see 'The Trouble with Unneeded Bankruptcy Reform: The LSTA's Response to the ABI Commission Report' (October 2015).
[82] The US, however, has enacted and implemented the Small Business Debtor Reorganization Act 2019 which adopts and modifies certain aspects of the ABI Commission report. In particular, it removes the requirement that holders of 'equity' as distinct from debt in the small business debtor have to provide new value to retain their equity interest in the debtor without paying creditors in full
[83] See the discussion at pp 249-256 of the final report.
[84] See also the discussion of exculpatory clauses at pp 249-252 of the final report.

Non-debtor parties may be reluctant to contribute to the plan if the non-debtor party might be exposed to liability or will have ongoing liability despite confirmation of the chapter 11 plan. On the other hand, limiting creditors' recoveries to those provided under the plan may substantially change the nature of their rights against non-debtor parties, and in turn further reduce their overall recoveries. Non-debtor parties may be receiving a windfall at the creditors' expense.

The Commission observed the challenges in formulating a general approval standard for such non-consensual releases and analysed the multi-factor tests used by the courts including the *Dow Corning* and *Master Mortgage* cases, respectively. On balance, it determined that the *Master Mortgage* factors adequately captured the careful review required in these cases and declined to incorporate separate identification of unique or unusual circumstances.

Notwithstanding this report, third-party, or non-debtor, releases have continued to attract attention in the US from both commentators and legislators in the wake of recent cases such as *Purdue Pharma LP*[85], *Boy Scouts of America*[86] and *USA Gymnastics*[87]. A Nondebtor Release Prohibition Act has been introduced in the US Congress which aims at limiting, if not prohibiting entirely, the use of third-party releases in such cases.[88]

The complaint is that bad actors who have not filed for bankruptcy have tried to escape personal accountability for their actions by shielding themselves through a bankruptcy proceeding of another corporation or entity. Non-consensual, non-debtor releases have been implemented in recent bankruptcy cases including the USA Gymnastics and Boy Scouts of America bankruptcies. In these cases, victims of sexual assault and abuse have had their cases dragged into bankruptcy courts against their will. The aim of the projected legislation is to expand access to justice for those harmed by bad actors.

[85] 633 BR 53 (Bankr SDNY) and on appeal (2021) 635 BR 26 when the first instance decision was reversed.

[86] See https://abcnews.go.com/Politics/wireStory/boy-scouts-24-billion-bankruptcy-plan-upheld-judge-98192501

[87] See https://www.onfocus.news/settlement-with-survivors-approved-by-court-usa-gymnastics-to-exit-bankruptcy/

[88] See https://www.congress.gov/bill/117th-congress/house-bill/4777

Perhaps the most high profile case involved *Purdue Pharma*[89] and America's opioid addiction crisis. Purdue Pharma was a privately-held company owned by Sackler family members and most of the company's billion in annual revenue was derived through Oxy Contin sales.

The company pleaded guilty to falsely marketing its product and paid $600 million in fines. Civil suits mounted, and Sackler family members were being named as defendants. The Purdue bankruptcy judge found the Sacklers distributed significant sums of Purdue money to themselves at a time when they were aware of the opioid crisis and the litigation risk and acknowledged that the withdrawals substantially reduced the company's solvency cushion. The bankruptcy court found that distributions to insiders would allow Purdue's bankruptcy estate to assert more than $11 billion in avoidable transfer claims.

Purdue filed a chapter 11 petition, and the bankruptcy court promptly approved a temporary injunction barring suits against the Sacklers and the company's officers, directors or employees. The injunction stopped thousands of suits against the company and hundreds against the Sacklers personally. The injunction was upheld on appeal and extended 18 times, until the plan was confirmed.

In exchange for broad releases of both direct claims against the Sacklers and derivative claims that could be asserted by the bankruptcy estate, the Sacklers agreed to pay $4.3 billion over 9 years through Purdue's Chapter 11 Plan. The plan was approved by a supermajority of each class of creditors but the US Trustee and several States attorneys general objected to the plan on account of its broad third-party releases.

The Purdue bankruptcy judge held that that failure to confirm the plan would lead to the company's liquidation and no recovery for unsecured creditors, including personal injury plaintiffs. The plan was confirmed with the third party releases intact.

The District Court (Judge Colleen McMahon) reversed holding that the US Bankruptcy Code does not authorise such non-consensual non-debtor releases; not in its express text nor in its silence and nor in any section or sections of the Code. The court interpreted the releases to mean that if the Sacklers were jointly and severally liable as tortfeasors with Purdue Pharma, they were released from tort or statutory actions that might have been brought directly by injured victims of Oxy Contin. Such causes of action belonged to the individual creditors, not to the bankruptcy estate. In her view, 'channeling injunction' that prohibiting suits against the

[89] See the analyses by Judge Robert Drain in *In re Purdue Pharma, LLC* (2021) 633 BR 53 (Bankr SDNY) and by Judge Colleen McMahon on appeal (2021) 635 BR 26 when the first instance decision was reversed.

Sacklers for tortious acts that they committed constituted an expropriation of property owned by individual creditors.

The non-debtor releases gave the Sackler family global peace for their alleged role in the opioid crisis. A non-debtor release operates as a bankruptcy discharge without a filing and without the safeguards of the US Bankruptcy Code. Beneficiaries such as the Sacklers have the benefits of bankruptcy without its burdens, including obligations of transparency (financial disclosure) and accountability (giving most assets to creditors).The Sackler releases are as hot as bankruptcy gets in the US and critics have called them an outrage, shocking and flatly unconstitutional.[90] There have even been complaints about the Purdue Pharmacy bankruptcy filing being heard before a particularly favoured judge.

The US bankruptcy process contains many desirable benefits for mass-tort defendants. It provides a centralised proceeding for resolving claims and a forum of last resort for many companies to aggregate and resolve mass-tort liability. It could be argued that the bankruptcy process represents an appropriate balance between debtors with limited resources and many claimants seeking payment.

Critics have however contended that non-debtor releases do not advance any legitimate bankruptcy policy and simply provide a contrived means for solvent non debtors to impose extraordinary mandatory settlements of their mass tort liabilities upon non consenting victims. Efficient and fair joint settlements of mass tort liability claims will still be possible, even if non-consensual non-debtor releases are prohibited.

The expression 'grifters' has been invented to refer to non debtors who take advantage of situations and latching on to others for benefits they do not deserve.[91] Courts have allowed the Bankruptcy Code's mechanisms to be used by solvent, non-debtor companies and individuals facing mass-litigation exposure. It is argued that these 'bankruptcy grifters' act as parasites, receiving many of the substantive and procedural benefits of a host bankruptcy, but incurring only a fraction of the associated burdens. In exchange for the protections of bankruptcy, a debtor incurs the reputational cost and substantial scrutiny mandated by the bankruptcy process. Bankruptcy grifters do not. This dynamic has become evident in a number of high-profile bankruptcies filed in the wake of pending mass-tort litigation, such as the Purdue Pharma and USA Gymnastics suits.

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[90] See, for instance, R Brubaker, 'Mandatory Aggregationof Mass Tort Litigation in Bankruptcy' (2022) 131 Yale LJ Forum 960); W Organek, '"A Bitter Result": Purdue Pharma, a Sackler Bankruptcy Filing, and Improving Monetary and Nonmonetary Recoveries in Mass Tort Bankruptcies' (2022) 96 AM BANKR LJ 102.

[91] See Lindsey Simon, 'Bankruptcy Grifters' (2022) 131 Yale LJ 1154.

Forum shopping has long been a concern in chapter 11 cases. Indeed, before nondebtor releases, it may have been the hottest topic in US bankruptcy. The power to choose the forum for a large bankruptcy reorganisation is a powerful weapon and may be determinative of the outcomes of cases. There has been various unsuccessful attempts, to reform the 'venue' provisions in the US Code which allow bankruptcy proceedings to be filed where a debtor is incorporated; where it has its principal place of business or where an affiliate has already filed for bankruptcy.[92]

The Southern District of New York and Delaware has been particularly favoured as bankruptcy forum shopping venues. While US bankruptcy law is federal law,[93] different bankruptcy courts differ in their interpretation of particular Bankruptcy Code provisions; different courts adopt different procedural rules and some judges are more experienced in bankruptcy matters than others.[94] Since the so-called 'great recession' in 2007, empirical evidence suggests that about 70 per cent of large corporate bankruptcies are 'forum shopped' to a district other than where the debtor has its principal place of business.[95]

Professor LoPucki has decried the persistence of court competition. There have been concerns about the distortions that arise from repeat play in chapter 11. Large cases tend to be dominated by a small number of judges, law firms and distress professionals who appear together frequently in a few select districts that some argue seek big cases.

Forum shopping and 'grifting' are also possible concerns in a UK debt restructuring context . The time has come to shift the attention back to the UK to see whether there are real concerns.

4. Forum shopping and 'grifting' in a UK context

The leading case on 'grifting' in the UK debt restructuring context, though that precise terminology was not used, is that arising out the Turner and Newall (T & N) asbestos liability

[92] 28 USC 408.

[93] Art 1, section 8, cl 4 of the US Constitution.

[94] For a full-blooded critique of bankruptcy forum shopping in the US see LM LoPucki, *Courting Failure: How Competition for Big Cases Is Corrupting the Bankruptcy Courts* (University of Michigan Press 2005) but for rebuttals of the LoPucki thesis see MB Jacoby, 'Fast, Cheap, and Creditor-Controlled: Is Corporate Reorganization Failing?' (2006) 54 *Buffalo Law Review* 401 and also K Ayotte and D Skeel, 'An Efficiency-Based Explanation for Current Corporate Reorganization Practice' (2006) 73 *University of Chicago Law Review* 425.

[95] See UCLA-LoPucki Bankruptcy Research Databa accessible at *https://lopucki.law.ufl.edu/index.php*.

claim - *T&N Ltd (No. 3)*.[96] The scheme in that case was between T&N Ltd and various associated companies, on one side and employees and former employees, on the other side. The employees and former employees had claims for personal injuries arising out of their exposure to asbestos. The claims included in the scheme were restricted to those covered by employers' liability insurance. The insurers had disputed liability on grounds, inter alia, of alleged misrepresentation but agreed to pay the sum of £36.74 million to the T&N companies administrators on the basis that a binding scheme of arrangement was put into place and approved by the court. Under this scheme, actual and potential claimants would agree not to bring claims against the insurers in return for being paid a dividend out of that fund.

Under the Third Parties (Rights Against Insurers) Act upon entering administration, the rights of T&N and the other companies under the policies (in respect of liabilities which had by then been incurred) were transferred to the creditor claimants and these rights were compromised under the scheme. The argument against sanction of the scheme was that it was outside the scheme legislation because the scheme only affected the rights between the employee creditors and the insurers and was not a compromise or arrangement between the company itself, T&N, and its creditors.

[96] [2006] EWHC 1447 (Ch), [2007] Bus LR 1411.

David Richards J dismissed this objection on the ground that the rights of the claimants had against the insurers were sufficiently connected with the claimants' rights against T&N so as to bring the proposed arrangement within the relevant provisions. In his view, the scheme involved a settlement of litigation. In substance and form, it was a tripartite matter, involving T&N, insurers and claimants. The scheme has no effect on the present rights of claimants against T&N. Claimants could assert their claims against T&N with the latter defending those claims. Claimants were not obliged to proceed first against the trust to be established by the scheme. If however, a claimant established a claim under the trust distribution procedures and received a payment, it would diminish the amount that T&N would otherwise be required to pay in respect of the claim. Although not immediately affecting rights against T&N, the scheme was likely therefore to have an impact on those rights. The scheme was an integral part of a single proposal affecting all the parties, which included also the trust and the trust distribution procedures.

It is clear from *T & N Ltd* that whatever the precise meaning of a compromise or arrangement, it needs to be proposed with creditors or members of a company. David Richards J also made it clear that the looser the connection between the subject-matter of the scheme and the relationship between the company and creditors concerned, the more substantial might be the objections on discretionary grounds to sanctioning the scheme.

T&N Limited was distinguished on it facts by the Court of Appeal in *Lehman Bros*[97] but the court was satisfied as to the correctness of the decision. Neuberger LJ said[98] that the scheme

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[97] *Re Lehman Brothers International (Europe) (No 2)* [2010] Bus LR 489.

[98] Para 83.

claimant's rights:'(a) were closely connected with their rights against the company as creditors; (b) were personal, not proprietary, rights; and (c) if exercised and leading to a payment by the insurers, would have resulted in a reduction of the creditors' claims against the company.'

Patten LJ said[99] that it was 'entirely logical to regard the court's jurisdiction as extending to approving a scheme which varies or releases creditors' claims against the company on terms which require them to bring into account and release rights of action against third parties designed to recover the same loss. The release of such third party claims is merely ancillary to the arrangement between the company and its own creditors.'

In *Lehman* the finance company held certain securities as trustee but the records of the finance company were not sufficiently detailed and up to date to enable precise identification, within a reasonably short period of time, of the persons for whose benefit the securities were held. The question arose whether a scheme of arrangement could effectively be used to plug the gap in record-keeping.

The scheme proposed and considered in *Lehman* was for the modification of proprietary rights i.e. that trust beneficiaries should be compelled to give up their entitlement to their own property held by the company on their behalf. The court held that the scheme jurisdiction was not intended to encompass the rearrange proprietary rights in this way. The latter rights are sacrosanct, so to speak.

Nevertheless, it is clear that the variation or release of rights against third parties can properly form part of, or even, in the right circumstances, constitute the proposals embodied in a scheme. The recent scheme or restructuring plan cases have not so much involved personal injury litigation but financial mis-selling litigation, in particular the *Amigo Loans* case[100] where the court initially refused to sanction the restructuring proposal.

Basically, the court in this case was not satisfied in relation to the evidence about imminent insolvency. Moreover, the directors had not adequately explored the prospect of a better alternative to the scheme in particular, through a market recapitalisation to raise funds to pay creditors and / or an equitization of the creditor claims i.e. full or partial conversion of debt into equity. Therefore, at the approval of the majority at the scheme meeting was not representative of the class as a whole. They were not able to take a properly informed view, having regard to the deficiencies in the explanatory statement.[101] Despite their protestations

[99] Para 63
[100] Reported as *In Re ALL Scheme Limited* [2021] EWHC 1401 (Ch) (Miles J)
[101] The objections of the Financial regulator, the Financial Conduct Authority (FCA) proved crucial.

to the contrary, the judge was not satisfied that the company was unable to propose better terms. This ultimately proved to be the case.[102]It appears that delay and holding out did not destroy value, but instead drove the controllers of the company to pay more to keep it alive.

Alongside debt owed to financial creditors, the *T & N* case shows the potential use of the UK scheme where the underlying debt is debt owed to tort claimants. The fact that the UK may now serve as a venue for international mass tort litigation is highlighted by the decisions of the UK Supreme Court in the *Vedanta Resources*[103] and *Okpabi*[104] cases. In both these cases, it was held to be arguable that the UK parent could be liable for the operations of its overseas subsidiaries. In these cases, there was actual or potential injuries and disease to persons, as well as damage to the natural and physical environment. If there are mass tort cases with the UK being use as a venue for such cases, so too is there the risk of massive liabilities.

There is also the possibility of the UK being used as a venue for restructuring such liabilities through schemes/plans in the same way that it is being used as a venue for restructuring international financial debt. 'Social debt' is however, likely to generate more contentious issues than purely financial debt and this militates against the prospects of scheme/plan achieving international recognition. There may be objections to the venue choice in favour of the UK and possible use of public policy as a weapon to obstruct recognition of schemes/plans stemming from such proceedings. A more subtle weapon might be to suggest that the interests of certain 'non centrally positioned' creditors and others impacted by the restructuring process have not been adequately protected. 'Adequate protection' or 'sufficient protection', to use the equivalent US expression, is a requirement under Articles 21 and 22 of the UNCITRAL Model Law on Cross Border Insolvency which both the US and UK have implemented into their national cross border insolvency law[105]

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[102] See *IN THE MATTER OF ALL SCHEME LTD* [2022] EWHC 1318 where Trower J sanctioned a revised scheme

[103] *Vedanta Resources Plc v Lungowe* [2019] UKPC 20 finding an arguable case that the UK parent could be liable for the operations of its overseas subsidiary

[104] *Okpabi v Royal Dutch Shell plc* [2001] UKPC 3.

[105] In the UK, the Model Law has been implemented through the Cross Border Insolvency Regulations (CBIR) 2006 (SI 2006/1030). Reg 2 provides that '(1) The UNCITRAL Model Law shall have the force of law in Great Britain in the form set out in Schedule 1 to these Regulations (which contains the UNCITRAL Model Law with certain modifications to adapt it for application in Great Britain)'. In the US, it has been done through a new Chapter 15 of the US Bankruptcy Code. The model law is available on the UNCITRAL website at https://uncitral.un.org/en/ texts/insolvency/modellaw/cross-border_insolvency and for a list of countries that have adopted the model law see https://uncitral.un.org/en/texts/insolvency/modellaw/crossborder_insolvency/status. The national implementations of the Mode Law varies in some respects. Moreover, for comparisons with the EIR see R Bork, 'The European Insolvency Regulation and the UNCITRAL Model Law on Cross-Border Insolvency' (2017) 26 *International Insolvency Review* 246.

5. **Conclusion**

In the UK, the scheme/plan process undoubtedly favours consensus over conflict but it can be a coercive process. The same is also essentially true of the US Chapter 11 process. The debtor’s stakeholders are effectively forced into a single forum and in forum, supermajority voting can radically alter individual rights through a confirmed scheme/ restructuring plan. That scheme/plan, and ‘deals’ leading to it, presumptively seek to maximize the value of the debtor’s assets, through doctrines that partly focus on distributive rights, such as the relative priorities of creditors’ claims to the value of the debtor’s enterprise. These doctrines may work reasonably well when underlying liability is not in serious dispute.

Disputes however, can also become more embittered when it comes to resolve disputed liability over tortuously generated debt where there are competing social interest considerations. Part of the concern is that these ex ante bargains may be coercive and developed by a small group of key stakeholders. The ‘deals’ are then log-rolled through other constituencies whose support the original participants believe that they need. Those on the inside in any given deal may have little interest in protecting those outside of it or on the margins. The deals are effectively presented on an ‘emergency’ or ‘necessary’ basis to the court. The latter is given good reason to worry that if it fails to approve the deal, the relevant company may collapse and more formal insolvency proceedings will have to be instituted and/or brought to a conclusion with loss of value for all stakeholders.

In the US, Chapter 11 ‘deals’, more or less pre-packaged or gift wrapped, are then largely shopped to desirable ‘forum shopping’ venues such as Southern District of New York or Delaware where judges are renowned for their legal expertise, sophistication and proficiency in managing large and complicated Chapter 11 cases. For some, the whole process leaves a sour taste in the mouth but for others it is very much understandable and excusable. For example, the Delaware lobby has an influential advocate in US President and former Delaware Senator, Joe Biden. Mr Biden has argued that some bankruptcy courts develop specialized knowledge and experience and it is understandable for parties to want cases to be adjudicated in locations where they feel most comfortable.[106] Mr Biden’s arguments can be translated into the international level. There is also the argument that creative competition among jurisdictions

[106] See J Biden, 'Give Credit to Good Courts' *Legal Times* 20 June 2005: 'One of the states . . . singled out for criticism is my state of Delaware, a jurisdiction widely respected for the quality, efficiency, expertise, and fairness of its bankruptcy courts.'

for the optimum set of restructuring law provisions will promote aggregate social welfare.[107]The existence of jurisdictional diversity creates the opportunity for competition among national legal orders. On this analysis, the general welfare is maximised through the adoption of innovative rules at the national level and then giving parties a relatively free hand in selecting such rules to govern their relationships.[108]

Forum shopping has long been discussed in the UK debt restructuring context with the UK seen as a good and attractive forum shopping venue through the use of schemes of arrangement and now restructuring plans.[109] The UK courts invariably require evidence that the scheme/plan is likely to be recognised where the debtor has assets and therefore produce benefits for creditors. The corollary however, is also likely to be the case. In words, if there is convincing evidence that the scheme/plan will not be recognised where the debtor has assets, therefore the scheme/plan not likely to generate benefits for creditors and therefore it is not likely to be confirmed by the courts. The court does not act in vain.

What has been called in the US 'bankruptcy grifting' is tied to the success of the UK as an attractive forum shopping venue. If there is evidence of bankruptcy grifting working to the disadvantage of creditors or consumers resident typically in jurisdictions where the debtor has assets, then it is unlikely that the scheme/plan will be recognised in that jurisdiction and the

[107] For the much-cited argument about forum shopping in a municipal context see C Tiebout, 'A Pure Theory of Local Expenditures' (1956) 64 *Journal of Political Economy* 416.
[108] See generally A Ogus, 'Competition between National Legal Systems: A Contribution of Economic Analysis to Comparative Law' (1999) 48 *International and Comparative Law Quarterly* 405; F Easterbrook, 'Federalism and European Business Law' (1994) 14 *International Review of Law and Economics* 125.
[109] See J Payne, 'Debt Restructuring in transition' (2023) 139 LQR 101; S Paterson and A Walters, 'Selective Corporate Restructuring Strategy' (2023) 86 MLR 436.

attractiveness of the UK as restructuring venue to that particular forum shopper will fade away. The limits of contractualism, so to speak, come to the fore.