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The Thing about Schemes in the Scheme of Things: Recognition of Schemes of Arrangement under Chapter 15 of the U.S. Bankruptcy Code

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Acknowledgement

INSOL International is very pleased to present a technical paper titled “The Thing about Schemes in the Scheme of Things: Recognition of Schemes of Arrangement under Chapter 15 of the U.S. Bankruptcy Code” by David L. Lawton and Shannon B. Wolf, both of Bracewell LLP, USA.

Chapter 15 of the United States Bankruptcy Code (the “Code”) allows the foreign representative of an eligible debtor to seek recognition of the debtor’s “foreign proceeding” in the US courts. Whilst U.S. bankruptcy courts have routinely recognised schemes of arrangement, it is arguable that a scheme in its various forms, may not strictly qualify as a “foreign proceeding” under Chapter 15. Questions arise, for example, as to whether a scheme is a “collective proceeding” when each class must be schemed separately; and whether the assets and affairs of the debtor are in fact “subject to control or supervision by a foreign court” in a scheme.

This interesting paper examines the relevant legal components of the interpretation of “foreign proceeding” under the Code. It reviews the common and distinct characteristics of the proceedings in various jurisdictions labelled as “schemes of arrangement,” including schemes in the UK, Australia, South Africa and the Cayman Islands; and provides an analysis of the treatment by U.S. courts of applications for recognition of schemes of arrangement under different jurisdictions to date.

It concludes by providing useful practical guidance for insolvency practitioners who may consider applying for recognition of a scheme of arrangement as a foreign proceeding under Chapter 15, highlighting the factors that may contribute to their success or failure.

INSOL International sincerely thanks David L. Lawton and Shannon B. Wolf for this detailed analysis and for writing this excellent technical paper.

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The Thing about Schemes in the Scheme of Things: Recognition of Schemes of Arrangement under Chapter 15 of the U.S. Bankruptcy Code

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1. Recognition of schemes under Chapter 15, generally

Both state and federal courts in the United States of America may recognise, generally, the judgments and orders of foreign courts. The authority to recognise foreign judgments and orders related to foreign insolvency proceedings is found in Chapter 15 of the United States Bankruptcy Code (the Code), which was enacted to incorporate the UNCITRAL Model Law on Cross-Border Insolvency 1997 (the Model Law) and thereby provide "an effective mechanism for handling cases of cross-border insolvency."[1] A case under Chapter 15 is ancillary to a foreign insolvency proceeding or proceedings and permits the U.S. court to cooperate with foreign courts in respect of such foreign proceedings to promote the fair and efficient administration of such proceedings and protect and maximise the value of the debtor's assets for the benefit of all creditors and interested parties, including the debtor.[2]

A case under Chapter 15 is commenced upon the filing of a petition for recognition of a foreign proceeding by a debtor's foreign representative in a U.S. bankruptcy court. The petitioner must demonstrate, among other things, that the foreign proceeding is "a collective judicial or administrative proceeding in a foreign country . . . under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court for the purpose of reorganization or liquidation."[3] The court has broad discretion to grant provisional relief to the debtor upon the filing of a petition under Chapter 15. Upon recognition of a foreign proceeding as a foreign *main* proceeding (i.e., a proceeding in a jurisdiction in which the debtor has its center of main interests (COMI)), certain relief is granted automatically (for example, the application of the automatic stay under 11 U.S.C. § 362 with respect to the debtor and its property within the territorial jurisdiction of the United States).[4] Moreover, whether the foreign proceeding is recognised as "main" or "nonmain," the court may also grant appropriate relief as "necessary to effectuate the purpose of [Chapter 15] and to protect the assets of the debtor or the interests of the creditors" (including a stay of a specific action, a stay of any execution against the debtor's assets, discovery and the taking of evidence concerning the debtor's assets, and other relief as the court may order).[5]

Although schemes of arrangement may not be classic collective insolvency procedures, U.S. bankruptcy courts have routinely recognised them as "foreign proceedings" under Chapter 15 as schemes have become key restructuring tools in the UK and across the globe in Commonwealth and related jurisdictions. Schemes are flexible procedures under corporate statutes allowing companies, with minimal judicial oversight, to reorganise on a substantially consensual basis, often as a value-preserving alternative to liquidation. The flexibility of a scheme permits a borrower to negotiate and enforce new terms with a single class of equity holders or creditors – or to substantially restructure a company's entire capital structure. Schemes of arrangement have

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[1] 11 U.S.C. § 1501(a).
[2] *Id.*
[3] *Id.* § 101(23).
[4] *Id.* § 1520(a).
[5] *Id.* § 1521.

become one of the premier international restructuring procedures globally, and debate continues as to whether Chapter 11 or the scheme is the most effective procedure.[6]

Arguably one of the most important elements of the scheme is its cramdown provision, which allows a substantial majority to circumvent unanimous documentary restrictions that could otherwise prevent reorganisation. For this reason, and to avoid liquidation or other value-destructive procedures, a meaningful number of restructurings in the UK and other English law derivative jurisdictions employ schemes of arrangement. Schemes permit companies and their relevant stakeholders to take advantage of the flexibility and privacy of out-of-court negotiations. Once an agreement is reached, implementation via a scheme is relatively simple and expedient in most cases, and the court's involvement is typically minimal: certifying the composition of classes, approving a meeting of creditors to vote on the proposed scheme and, if a favourable vote is obtained, sanctioning the scheme.

Chapter 15 of the Code allows the foreign representative of an eligible debtor to seek recognition of the debtor's non-U.S. "foreign proceeding." A "foreign proceeding" is defined under the Code as:

> "…*a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation*."[7]

As explained below, schemes of arrangement may not always fall neatly into the Code's definition of "foreign proceeding." Nonetheless, U.S. bankruptcy courts have increasingly recognised schemes of arrangement as foreign proceedings under Chapter 15, including in several recent cases recognising Australian, Cayman and South African schemes.

In some of these cases, the court is willing to enforce a scheme approved by a foreign court in the context of a more classic collective proceeding (*i.e.*, as part of a provisional liquidation or as proposed by an administrator in the context of an administration). However, U.S. bankruptcy courts have also recognised schemes of arrangement themselves as "foreign proceedings," typically in the absence of any objection by parties in interest and often based on precedent – namely, the fact that other courts have recognised schemes of arrangement as foreign proceedings under Chapter 15. In many such opinions and orders recognising schemes as foreign proceedings, courts have offered little to no analysis as to whether a particular scheme of arrangement satisfies the Code's definition of a foreign proceeding. Some give no specific indication that the court considered the definition under 11 U.S.C. § 101(23) and focus instead on whether the proceeding is a foreign *main* proceeding or foreign *non-main* proceeding under section 517 of the Code – especially where the only objections relate to COMI or some other aspect of recognition under Chapter 15.

In sum, one might consider the scheme of arrangement in its many forms as wholly recognisable as a foreign proceeding under Chapter 15 of the Code – and there would be little case law to disprove such a conclusion. Nevertheless, such precedent remains untested because U.S. courts have had little – if any – opportunity to consider recognition of a scheme of arrangement as a foreign proceeding in a scenario in which a significant party-in-interest has objected to the scheme as failing to satisfy the requirements of a foreign proceeding under 11 U.S.C. § 101(23), especially where a proposed scheme lacks indicia of a collective proceeding (for example, only involves a small portion of the debtor's creditors) or there is no evidence that the court to which the company has applied for sanctioning of a scheme has taken control or supervision over the assets and affairs of the company. Without testing the limitations of scheme recognition, existing precedent may give the false impression that any proposed scheme will be automatically recognised under Chapter 15. But the flexibility and variability of schemes (valuable attributes) belie the assumption that recognition of schemes under Chapter 15 is a one-size-fits-all judicial inquiry. It is possible

[6] *See, e.g.,* E. McGovern, United States: Schemes of Arrangement for Distressed Shipping Companies – A Viable (And Cheaper) Alternative to Chapter 11? (May 2015), available at http://www.mondaq.com/unitedstates/x/400664/Insolvency+Bankruptcy/Schemes+Of+Arrangement+For+Distressed+Shipping+Companies+A+Viable+And+Cheaper+Alternative+To+Chapter+11; A. Zacaroli QC & A. Riddiford, Scheme of Arrangement and Chapter 11 of the US Bankruptcy Code: a comparative view, South Square Digest (Dec. 2015), available at http://www.insol.org/emailer/December_2015_downloads/Document13.pdf.

[7] 11 U.S.C. § 101(23).

that most future schemes will be routinely recognised as foreign proceedings under Chapter 15, especially in the absence of meaningful objections to recognition. But practitioners should be wary of relying on precedent for recognition of standalone schemes (schemes proposed outside of any other judicial or administrative appointment or proceeding) and carefully consider the risk that any opposition (*e.g.*, creditors who voice opposition to a scheme by vote and before the sanctioning court where such scheme was nonetheless approved over such objections) may prevail in their objection to a bankruptcy court's recognition of such schemes as foreign proceedings under Chapter 15.

The purpose of this paper is not to fully distinguish the provisions of each statutory scheme around the globe, but highlighted below are some distinctions that may affect the likelihood of recognition under Chapter 15.

2. Schemes of arrangement – some jurisdictional distinctions

United Kingdom

Schemes of arrangement are generally classified as corporate transactions, among others such as amalgamations, mergers, etc. In the UK, a scheme of arrangement is a statutory procedure under Part 26 of the Companies Act 2006 by which a company may enter into a court-approved compromise or arrangement with its creditors or its members, or any class of creditors or members upon an application made by the company, any creditor or member of the company, or an administrator or liquidator of a company in administration or liquidation, respectively.[8] Upon proper notice, and after a court-ordered meeting of the relevant creditors or members, the court may approve a scheme that is approved by a majority in number and 75% in value (if applicable) of the creditors or members (or class thereof) present and voting at the meeting.[9]

Pre-Brexit (the prospective withdrawal of the UK from the European Union) the UK scheme of arrangement has been the preeminent European reorganisation proceeding. Brexit creates potential obstacles to cross-border restructurings, particularly with respect to UK insolvency proceedings involving other member states of the European Union. One such obstacle is the difficulty in recognising a non-EU UK proceeding. Among the various unilateral, bilateral and multilateral solutions available would be for European Union member states to adopt the Model Law into local law. However, merely adopting the Model Law as drafted may be insufficient to ensure recognition of a scheme of arrangement. Although it is one of the most commonly used proceedings worldwide to effect a corporate restructuring, the scheme of arrangement is not technically an insolvency proceeding in many of its forms – and is not recognised as a collective insolvency procedure under the EU Regulation on insolvency proceedings (1346/2000/EC) (the EIR). But UK schemes of arrangement may persist as the European go-to restructuring procedure and, moreover, similar corporate statutes authorise schemes of arrangement in many other countries, most with ties to the UK.

Australia

In Australia, part 5.1 of the Corporations Act 2001 provides for a scheme of arrangement substantially similar to a UK scheme. In Australia, a scheme may bind creditors holding certain subordinated claims without the court ordering a meeting for such subordinated creditors, and the court may grant its approval to a scheme subject to such alterations and conditions as it thinks just.[10] The Australian scheme provides for the appointment of a person to administer the

[8] Companies Act of the U.K. (the "Companies Act"), 2006 c. 46 pt. 26, available at https://www.legislation.gov.uk/ukpga/2006/46/part/26.

[9] The Companies Act contains additional provisions that apply to specific types of debtors, such as provisions concerning solvent insurance schemes. Parties have debated whether solvent insurance schemes should be recognised under Chapter 15. Some of the same arguments may apply to general schemes of arrangement (plain language of the statute versus congressional intent, lack of pre- and post-sanction relief in a scheme proceeding, etc.), but solvent insurance schemes involve specific distribution requirements under UK law relative to long-term insurance businesses – and whether such provisions should be granted comity under Chapter 15 is not the subject of this paper. *See, e.g.*, Susan Power Johnston & Martin Beeler, *Solvent Insurance Schemes Should not be Recognised [Reprised]*, 17 NORTON J. BANKR. L. & PRAC. 903 (2008); *see also, e.g., In re Hopewell Int'l Ins. Ltd.*, 238 B.R. 25 (Bankr. S.D.N.Y. 1999) (granting comity to a Bermuda solvent insurance scheme under former 11 U.S.C. § 304 (repealed); and *In re MMA Account, written by Les Mutuelles du Mans Assurance IARD*, No. 05-60100 (BRL), 2005 WL 3764946 (Bankr. S.D.N.Y. Dec. 7, 2005) (approving a solvent insurance scheme under Section 425 of the Companies Act of 1985 (UK) (superseded) as a foreign main proceeding under Chapter 15).

[10] Corporations Act of Australia, 2001 c.5, pt. 5.1, available at https://www.legislation.gov.au/Details/C2017C00328/Html/Volume_2#_Toc494872606.

compromise or arrangement. But not all scheme statutes are created equally. Schemes in various international jurisdictions have their own idiosyncrasies. For example, an Irish scheme of arrangement requires the company or debtor to have its COMI in Ireland, whereas a UK scheme merely requires a "sufficient connection" between the UK and the company subject to the scheme (which may be demonstrated by, for example, financing documents governed by UK law).

Canada

In Canada, arrangements under Section 192 of the Canada Business Corporations Act (CBCA) are available to *solvent* corporate applicants, within the meaning of subsection 192(2) of the Act. While certain Canadian courts have permitted insolvent corporate groups to effect arrangements as long as one of the relevant entities in the corporate group was solvent, the solvency requirement – in addition to other non-collective aspects typical to other scheme legislation – demonstrates that the CBCA does not clearly constitute a "collective judicial or administrative proceeding . . . under a law *relating to insolvency or adjustment of debt*." In fact, the policy on arrangements under section 192 of the CBCA provides for the Director appointed under the CBCA to call for adherence to the solvency limitation in response to applicants attempting to use section 192 of the CBCA to effect *insolvent* plans of arrangement:

> *Where it is not apparent from the affidavit materials provided with notice of the interim hearing that there is compliance with the solvency limitation, the Director may request additional financial information demonstrating compliance. Where the Director is not satisfied that compliance with the solvency limitation has been demonstrated, the Director may intervene.*[11]

Cayman Islands

In the Cayman Islands, a scheme of arrangement may be approved by the court in accordance with section 86, Companies Law (2013 Revision). Unlike most other "scheme" jurisdictions, in the Cayman Islands, a scheme of arrangement is the only formal means of imposing an in-court restructuring of a distressed or insolvent company. As an ancillary procedure to a provisional liquidation, the liquidator and the company's creditors may implement a restructuring via a scheme instead of winding up the company. However, in such a case, there is a formal, collective insolvency proceeding with an appointed liquidator – as opposed to a standalone corporate procedure.

South Africa

In South Africa, scheme mechanics are authorised under Companies Act 2008, No. 71 Of 2008, Sections 114 and 115. Section 155 of Chapter 6 of the Companies Act provides a compromise process for companies, regardless of financial distress, and allows the company to propose an adjustment of debt with respect to some or all of the company's creditors.[12] A South African scheme of arrangement includes arrangements solely between the company and its shareholders, including one or any of:

- a consolidation of securities of different classes;
- a division of securities into different classes;
- expropriations of securities from holders;
- exchanges of securities for other securities; and
- a reacquisition of the company's securities.[13]

Such shareholder arrangements, to the extent that they do not constitute "fundamental transactions" do not ordinarily require the sanction of a court.[14] However, the board of directors

[11] Policy on arrangements – *Canada Business Corporations Act*, section 192, ¶ 2(a) (available at https://www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs01073.html (as last modified Aug. 1, 2014)).
[12] *See* Companies Act § 155(1) (South Africa).
[13] *See* http://www.companylaw.uct.ac.za/usr/companylaw/downloads/legislation/WLB_2011-03_Cos_Act_fundamental_transactions_GD_HG.pdf
[14] *Id.*

of a company which is in liquidation or in the course of business rescue proceedings may not propose a scheme of arrangement."[15]

In theory, jurisdictional distinctions among scheme statutes add a layer of complexity to recognition analysis. And yet there are few distinctions that appear to have materially affected the analysis or outcome of an application for recognition of one scheme versus another in U.S. bankruptcy courts to date. As explained further below, one of the primary distinctions to be drawn from the cases recognising schemes of arrangement is whether recognition is sought for a standalone scheme of arrangement or whether the foreign representative seeks recognition of a distinct judicial or administrative proceeding (e.g., provisional liquidation) as the primary proceeding – either combined with a scheme or seeking enforcement of a scheme order as an ancillary judgment in the primary proceeding.

3. Recognition of a foreign proceeding under Chapter 15

The U.S. Bankruptcy Courts have authority and discretion to grant broad relief under Chapter 15, including provisional relief upon the filing of a petition for recognition under 11 U.S.C. § 1519; mandatory relief upon recognition under 11 U.S.C. § 1520 (for example, an automatic stay on any action with respect to property of the debtor within the territorial jurisdiction of the United States); and discretionary relief permitted upon recognition under 11 U.S.C. § 1521 (for example, staying the commencement of an individual action concerning the debtor's obligations or liabilities or suspending the right to dispose of any assets of the debtor).[16]

A proceeding may be recognised as a foreign proceeding for the purposes of Chapter 15 after a properly filed application satisfies certain, largely administrative, conditions pursuant to 11 U.S.C. §§ 1515 and 1517. Key among such conditions is the provision of a certified copy of the decision commencing the foreign proceeding and appointing the "foreign representative," and a certificate of the foreign court affirming the existence of such foreign proceeding and foreign representative.[17]

"Foreign proceeding" is defined in the Code as "a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purposes of reorganisation or liquidation."[18] However, the U.S. court is entitled to presume that the purported foreign proceeding is in fact a "foreign proceeding" (as defined in the Code) if the decision or certificate accompanying the petition so indicates.[19] Such presumption has arguably led to precedent in favour or recognising schemes of arrangement as foreign proceedings even if certain schemes may not clearly satisfy the qualifications set out in the definition above. Whereas a scheme of arrangement may not clearly constitute a "foreign proceeding" so defined, the U.S. bankruptcy court may presume it does – so long as the foreign court's certificate, for example, states that the scheme is a "foreign proceeding" – the phrase itself giving rise to the presumption without further inquiry into whether the foreign court intended to certify that such proceeding in fact falls within the defined term – and ultimately allowing the U.S. bankruptcy court to defer to the foreign court's interpretation of the Code.[20]

To establish that a proceeding is a "foreign proceeding" as defined under 11 U.S.C. § 101(23), the foreign representative must provide evidence that satisfies seven criteria:

1) the existence of a proceeding;

2) that is either judicial or administrative;

3) that is collective in nature;

4) that is in a country other than the United States;

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[15] *Id.*

[16] *See, e.g.,* Evan Flaschen & David Lawton, United States (Ch. 45), at 274-76, CROSS-BORDER INSOLVENCY II, A Guide to Recognition and Enforcement (INSOL International 2012).

[17] *See* 11 U.S.C. § 1515 (b)(1) and (2).

[18] 11 U.S.C. § 101(23).

[19] 11 U.S.C. § 1516.

[20] *See generally* 11 U.S.C. § 1515(b)(2).

5) that is authorised or conducted under a law related to insolvency or the adjustment of debts;

6) in which the debtor's assets and affairs are subject to the control and supervision of a foreign court; and

7) which proceeding is for the purpose of reorganisation or liquidation.[21]

U.S. courts have broadly interpreted these requirements in recognising most foreign proceedings under Chapter 15, including petitions to recognise schemes of arrangement. In connection with applications to recognise schemes of arrangement, U.S. bankruptcy courts have routinely assumed or concluded with cursory analysis that all seven categories are satisfied – especially where the facts demonstrate that the scheme was in fact used to restructure the debt of a distressed borrower – and where no party objected to recognition. Nonetheless, careful scrutiny reveals that not every scheme of arrangement – across the broad spectrum of possible schemes – will satisfy all seven criteria.

Criteria 1, 2, 4, 5 and 7

There is little debate that a typical scheme of arrangement satisfies criteria 1, 2 and 4. All schemes of arrangement are non-U.S. proceedings, and the vast majority of schemes are considered judicial proceedings – even if the court's involvement is minimal. Criterion 5 is likely satisfied with respect to most schemes of arrangement. Even if a company is not insolvent, or is not permitted to propose an *insolvent* scheme, most scheme legislation generally permits, *inter alia*, the restructuring of a company's debt. And recognition of a scheme by which a debt restructuring has been proposed or approved is generally the basis for seeking relief under Chapter 15. Similarly, criterion 7 will be satisfied with respect to most applications seeking recognition of a scheme because, such application generally seeks recognition of a scheme by which the debtor is being reorganised or liquidated – even if an individual scheme may be proposed for other reasons.

Criteria 3 and 6

Whether a typical scheme of arrangement satisfies the remaining requirements (criteria 3 and 6) as a "collective proceeding" in which "the debtor's assets and affairs are subject to the control and supervision of a foreign court" is less certain – and ultimately dependent on the facts in each case. Because a scheme of arrangement may be proposed in a variety of contexts to achieve various purposes, all schemes of arrangement will not universally satisfy these last criteria.

At a minimum, the "collective proceeding" requirement excludes receivership or other proceedings that are for the benefit of a single creditor or single class of creditors.[22] "A collective proceeding is one that considers the rights and obligations of all creditors."[23] As noted by multiple courts, the primary objective of Chapter 15 is the "fair and efficient administration of cross-border insolvencies that protects the interests of all creditors," which further supports the notion that a "foreign proceeding must be for the general benefit of creditors."[24] Thus Code section 101(23) contemplates both the consideration and eventual treatment of claims of various types of creditors, as well as the possibility that creditors, including general unsecured creditors, may receive notice and take part in the foreign action.[25] However, not all courts have interpreted "collective" to include "all" creditors or stakeholders, especially where the restructuring approved via a scheme has obtained overwhelming support.

In *In re Cell C Proprietary Ltd.*, the court's interpretation of "collective" seems to require a plurality of creditor – perhaps anything more than a single creditor. The court concluded that the South African scheme in question was collective "in that it seeks approval of an Arrangement, which is the adjustment of Cell C's debt with a group of creditors called the Compromise Creditors." The

[21] 11 U.S.C. § 101(23); *see In re ABC Learning Ctrs. Ltd.*, 445 B.R. 318, 327 (Bankr. D. Del. 2010); *In re Ashapura Minechem Ltd.*, 480 B.R. 129, 136 (S.D.N.Y. 2012); and *In re Cell C Proprietary Ltd.*, 571 B.R. 542, 549 (Bankr. S.D.N.Y. 2017).
[22] *See In re British Am. Ins. Co.*, 425 B.R. 884, 902 (Bankr. S.D. Fla. 2010); *see also In re Gold & Honey, Ltd.*, 410 B.R. 357 (Bankr. E.D.N.Y. 2009); COLLIER ON BANKRUPTCY ¶ 101.23 (Richard Levin & Henry J. Sommer eds., 16th ed.).
[23] *In re Betcorp Ltd.*, 400 B.R. 266, 281 (Bankr. D. Nev. 2009); *In re British Am. Ins. Co.*, 425 B.R. at 902.
[24] *See In re British Am. Ins. Co.*, 425 B.R. at 902; *In re Gold & Honey, Ltd.*, 410 B.R. at 370 n.16.
[25] *In re British Am. Ins. Co.*, 425 B.R. at 902.

fact that it was a group of creditors, while not all creditors, was dispositive – especially given "no objections to the relief sought by the Application were filed."[26]

In *Cell C*, the court noted that, earlier the same year, it had recognised a South African section 155 proceeding as a foreign proceeding in *In re Edcon Holdings Ltd*.[27] While the court did not rely exclusively on its precedent in *Edcon* in recognising the *Cell C* scheme, such reliance could become increasingly common and result in precedent susceptible to mischaracterisation: namely, the perception that a particular foreign statute authorising a scheme of arrangement in itself constitutes a "foreign proceeding" – instead of examining the actual scheme of arrangement proposed to determine whether it falls squarely – or sufficiently – within the definition of "foreign proceeding." While the "collective in nature" requirement has been found to be satisfied with respect to a scheme,[28] it is not clear that every scheme proposed would constitute a "collective proceeding." A scheme of arrangement may involve very few of a company's creditors or it may involve nearly all of them. And it may or may not implicate the interests of shareholders, who surely must be included, given that, in some cases, a scheme could relate only to shareholders and not creditors of the company.[29] Therefore, a scheme of arrangement is by no means collective by default because it may be limited to a distinct subset of interest holders or creditor and may not involve or resolve the claims and interests of most other stakeholders as would a typical collective insolvency procedure in which an administrator or the court has oversight over the entire company and all related claims and interests (for example, a case under Chapter 11 or most liquidation proceedings).[30]

The debate about whether a scheme is a collective proceeding has been significant in the context of recognising UK schemes under the EIR. The EIR applies to "collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator."[31] And, unlike Chapter 15, the EIR defines "insolvency proceedings" as those proceedings listed on Annex A thereto.[32] Annex A includes scores of insolvency proceedings, but it excludes schemes of arrangement. Reflecting the stated scope of the EIR, those proceedings included in Annex A "entail the partial or total divestment of a debtor," whereas a scheme of arrangement does not divest the debtor (even if a scheme may be proposed, for example, as part of an administrative proceeding where the debtor has already been divested, the debtor is not divested *by* the scheme). Of course, Chapter 15 contains different language, interpreted by U.S. courts, but the definition of "foreign proceeding" contains a similar requirement: the sixth criterion – that the "debtor's assets and affairs [be] subject to control and supervision of a foreign court."

This sixth criterion has not been interpreted by U.S. courts to require divestment, nor would it, given the nature of Chapter 11 proceedings in which the debtor retains possession of the estate and continues to manage the affairs of the debtor absent the appointment of a trustee. Nevertheless, it clearly requires something akin to divestment, at least in terms of authority or jurisdiction, because it refers to the "assets and affairs" – instead of merely claims, obligations or interests.[33]

U.S. bankruptcy courts that have considered this factor individually have generally concluded that the criterion is satisfied with respect to a given scheme because the scheme itself is subject to approval by the foreign court.[34] However, the statute specifically requires control *and* supervision of the company's assets *and* affairs.[35] Whether a company's directors and current management

[26] *In re Cell C Proprietary Ltd.*, 571 B.R. 542, 552, 554 (Bankr. S.D.N.Y. 2017).
[27] *Id.* at 553.
[28] *Id.*
[29] *See generally*, http://www.companylaw.uct.ac.za/usr/companylaw/downloads/legislation/WLB_2011-03_Cos_Act_fundamental_transactions_GD_HG.pdf.
[30] As explained above, a scheme is flexible enough to allow for a variety of corporate undertakings. The fact that a particular "restructuring" occurs pursuant to a scheme under the same corporations code or other corporate legislation as a previous scheme recognised by the same or a different court may have only marginal relevance to the question of whether a subsequent scheme should be recognised as a "collective proceeding." Nonetheless, it is possible that multiple rulings recognising a scheme of arrangement under a particular foreign law increases the likelihood that courts will "rubber stamp" future applications for recognition of schemes approved under the same law.
[31] Council Regulation 1346/2000 European Union Regulation on Insolvency Proceedings, 2000 O.J. (L 160) Ch. 1, art. 1, § 1.
[32] *Id.* at art. 2.
[33] Especially when taken together with the "collective proceeding" requirement, the control of "assets and affairs" requirement could be interpreted as a U.S. "partial divestment" requirement – at least requiring the proceeding to subject the debtor *in toto* to the control and supervision of the court – or an administrator.
[34] *See generally In re Ocean Rig UDW, Inc.* 570 B.R. 687 (Bankr. S.D.N.Y. 2017); *In re Cell C Proprietary Ltd.*, 571 B.R. 542 (Bankr. S.D.N.Y. 2017).
[35] 11 U.S.C. § 101(23).

continues to oversee the affairs of the debtor in bankruptcy or whether the debtor is wholly or partially divested of its affairs and assets under most other bankruptcy and liquidation proceedings, it is not clear that a company, by proposing a scheme of arrangement and seeking approval thereof by the court, has subjected its *assets and affairs* to the *control and supervision* of such court.

In a scheme of arrangement in which, however, the borrower proposes a scheme of arrangement approved by the requisite majority of its financial creditors in each class, the court has jurisdiction over the scheme itself – and perhaps, by extension, the fate of the entire company. Nonetheless, the court does not take control or otherwise supervise the borrower's affairs. The borrower need not seek permission from the court in connection with a scheme proceeding to enter into related party transactions, acquire or dispose of real estate, enter into transactions outside the ordinary course of business, liquidate a business line of the borrower, pay its advisors' fees, or otherwise take actions that might diminish the value of its business.

4. Applying the criteria to primary schemes versus ancillary schemes

Applications for recognition of schemes under Chapter 15 fall broadly into two categories:

(i) those schemes that are ancillary to a primary judicial or administrative foreign proceeding; and

(ii) those schemes which are themselves the primary foreign proceeding.

The former more easily satisfies the section 101(23) criteria, because it is layered on an insolvency procedure as a means of implementation instead of constituting a standalone procedure. The latter, a standalone scheme, will likely be approved absent meaningful objections but, as described above, is susceptible to challenge on the basis that it may not be a collective procedure in which the debtor's assets and affairs are controlled and supervised by the court.

4.1 Schemes recognised where the scheme of arrangement relates to a primary proceeding

In certain Chapter 15 cases involving schemes of arrangement, the foreign representative will not seek recognition of a standalone scheme but will seek recognition of a primary proceeding (provisional liquidation, administration, etc.) and secondarily seek to recognise and enforce a scheme of arrangement sanctioned by a foreign court as part of the primary proceeding. In such cases, provisional liquidators, administrators or trustees may have been appointed over the debtors under a procedure more classically relating to the insolvency or distress of the company. In turn, those liquidators or administrators may propose a scheme of arrangement to reorganise the company with a consensual supermajority. By layering the scheme on the base of a more classic insolvency proceeding, such proceeding falls more easily within the definition of "foreign proceeding" because the primary proceeding is more likely to be collective and to have the court or an administrator clearly controlling and supervising the debtor's assets and affairs.

A group of cases seeking recognition of Cayman schemes of arrangement illustrate this layering. In each case, provisional liquidators had been appointed over the debtor under Cayman law and subsequently negotiated and proposed schemes of arrangement under Cayman law. In one such case, *In re Ocean Rig UDW Inc.*, joint provisional liquidators of a Cayman company sought recognition of Cayman provisional liquidation proceedings and four schemes of arrangement (one for each debtor) that proposed "a major restructuring of the [their] financial debt, issuing new debt and cash and converting much of their fixed debt into equity, very substantially diluting the current equity ownership."[36] In *Ocean Rig*, the specific terms of the proposed schemes of arrangement were not yet at issue (having been proposed and voted but not yet sanctioned by the Cayman court). Considering the provisional liquidations and the schemes together, the court concluded that they were "collective judicial proceedings" and that, under Cayman law, the joint provisional liquidators were officers of the court and that "[a] Cayman's debtor's assets and affairs are subject to the control and supervision of the Cayman Court in both provisional liquidation proceedings and proceedings seeking sanctioning of schemes of arrangement."[37] The court cited other cases

[36] 570 B.R. 687, 689-91 (Bankr. S.D.N.Y. 2017).
[37] *Id.* at 701.

in which the Bankruptcy Court for the Southern District of New York had previously held that insolvency or debt adjustment proceedings and schemes of arrangement had qualified as foreign proceedings under Chapter 15.[38] However, many of the cases cited did not involve schemes of arrangement, and those that did were layered with provisional liquidation proceedings as in *Ocean Rig*.[39] Accordingly, while the holding of *Ocean Rig* arguably supports the notion that a Cayman scheme of arrangement that is not layered with liquidation or another insolvency proceeding is nonetheless a foreign proceeding in its own right, such a conclusion is rightly considered dicta because no non-layered Cayman scheme has been independently recognised – in *Ocean Rig* or in any of the other cited precedent.[40]

In *In re Suntech, Power Holdings Co., Ltd.*, (recognising a Cayman scheme of arrangement pursuant to an application filed by joint provisional liquidators in a provisional liquidation pending before the Grand Court of the Cayman Islands), the joint provisional liquidators were appointed at the request of a single creditor pursuant to section 104(3) of the Companies Law of the Cayman Islands (2013 Revision). In connection with their appointment by the court, the joint provisional liquidators were "expressly vested ...with a set of extremely broad operational and governance powers, including the authority to, among other things, monitor and oversee the day-to-day management of Suntech."[41] Such express vesting of control and supervision over the debtor's assets and affairs clearly satisfies such criterion under the definition of "foreign proceeding" – whereas such control and supervision under a standalone scheme would not be as obvious in most circumstances.

The *Suntech* and *Ocean Rig* petitions, unlike most other cases in which a scheme has been recognised, were not without objection, but the objection filed challenged the proceeding as a foreign *main* proceeding based on COMI – and not as a scheme of arrangement or even on the basis that it did not constitute a "foreign proceeding."[42] The court entered an order in which it summarily ruled that the Cayman provisional liquidation proceeding was "a foreign proceeding within the meaning of 11 U.S.C. § 101(23)."[43] In each of these Cayman cases, the provisional liquidators were appointed by the Cayman court's "Order Appointing Provisional Liquidators," wholly distinct from subsequent scheme proceedings. Under applicable Cayman law, the provisional liquidators are then entitled to propose a scheme of arrangement. Chapter 15 contemplates that a foreign representative will be appointed by the court in connection with the commencement of the foreign proceeding subject to an application for recognition.[44] Accordingly, the layered Cayman cases fit neatly within the definition of "foreign proceeding" under section 101(23) of the Code.

4.2 Schemes recognised where the scheme of arrangement stands alone as the foreign proceeding

Even where applicants seek recognition of a scheme of arrangement as a standalone foreign proceeding, courts continue to rely on precedent, presumption and the fact that a foreign court

[38] *Id.* at 701-02 (citing *In re Suntech Power Holdings Co.*, 520 B.R. 399 (Bankr. S.D.N.Y. 2014) (provisional liquidation); *In re Platinum Partners Value Arbitrage Fund*, No. 16-12925 (SCC) Bankr. S.D.N.Y. Nov. 23, 2016) (Dkt. No. 27) (official liquidation); *In re Ardent Harmony Fund, Inc.*, No. 16-12282 (MG) (Bankr. S.D.N.Y. Sept. 1, 2016) (official liquidation) (Dkt. No. 17); *In re Caledonian Bank Ltd.*, No. 15-10324 (MG) (Bankr. S.D.N.Y. Mar. 17, 2015) (Dkt. No. 39) (official liquidation); *In re LDK Solar Co.*, No. 14-12387 (PJW) (Bankr. D. Del. Nov. 21, 2014) (Dkt. No. 43, 44) (provisional liquidation *and* scheme of arrangement)).

[39] *See id.*

[40] For example, in *In re LDK Solar Co. Ltd*, the debtor's provisional liquidators likewise sought and were granted recognition of a Cayman scheme of arrangement coupled with a provisional liquidation. Order (i) Recognising the Cayman Proceeding of LDK Solar Co., Ltd. as a Foreign Main Proceeding and (ii) Granting Related Relief [Dkt. No. 43], and Order Recognising and Enforcing the Scheme of Arrangement and the Order of the Cayman Court Sanctioning the Scheme of Arrangement upon Recognition of the Cayman Proceeding [Dkt. No. 44], *In re LDK Solar Co.*, (In Provisional Liquidation), No. 14-12387-PJW (Bankr. D. Del. Nov. 21, 2014).

[41] *In re Suntech Power Holdings Co.*, No. 14-10383 (SMB), Verified Petition of Foreign Representatives ¶ 14 [Dkt. No. 2] (Feb. 21, 2014).

[42] *See* Objection of the Solyndra Residual Trust to Chapter 15 Petition [Dkt. No. 22], *In re Suntech Power Holdings Co. (in provisional liquidation)*, No. 14-10383 (SMB) (Mar. 17, 2014).

[43] Order (i) Recognising Foreign Main Proceeding; (ii) Denying Motion to Transfer Venue; and (iii) Granting Related Relief [Dkt. No. 71], *In re Suntech Power Holdings Co. (in provisional liquidation)*, No. 14-10383 (SMB) (Dec. 4, 2014).

[44] *See* 11 U.S.C. § 1515(b)(1) ("the decision commencing such foreign proceeding and appointing the foreign representative"). Note that, pursuant to the Code's rules of construction, the singular includes the plural. 11 U.S.C. § 102(7). Therefore, the commencement and appointment need not occur in the same decision, but the implication, at least, is that the foreign representative would be the representative with respect to such "foreign proceeding," which is a *collective* proceeding, i.e., over all of the debtor and its assets, rights and liabilities with respect to all equity holders, lenders, contract counterparties, etc. – and not merely with respect to distinct classes of obligations to be schemed.

has oversight, albeit minimal oversight, over the scheme proceedings. In most such cases, no parties objected to recognition. In *In re Edcon Holdings Ltd.*, the court entered an order summarily recognising a South Africa compromise proceeding under section 155 of the South African Companies Act as foreign main proceedings pursuant to 11 U.S.C. § 1517 and recognising and rendering enforceable the compromise (and related orders and documents) upon its effective date.[45] In *In re Cell C Proprietary Ltd.*, the court entered an order recognising as a foreign main proceeding a South African case approving a scheme of arrangement, and subsequently entered an order recognising and enforcing the arrangement itself.[46] In that case, at least two factors contributed to the approval of the scheme as a foreign proceeding. First and foremost, "…[n]o objections were raised in [the U.S. bankruptcy court] either to recognition of the South African Court proceeding as a foreign main proceeding or the recognition and enforcement of the [scheme of arrangement]."[47] The court implied in its description of the scheme proceeding under section 155 of the South African Companies Act 71 of 2008 that it is not necessarily a *collective* proceeding ("provides for a process to approve an 'arrangement' or 'compromise' that *may affect some or all* of a company's creditors.")[48] Unlike many other orders and opinions, even in the absence of any objections, the court restated the standard for establishing that a proceeding is a foreign proceeding, listing the factors as set forth in *In re ABC Learning Centers Ltd*.[49]

In other cases, recognition orders are entered with little or no evidence that the 101(23) factors have been considered, particularly in the absence of any objection to recognition.[50] And U.S. bankruptcy courts have recognised scheme proceedings as foreign proceedings even where the foreign court has yet to consider whether the scheme should be sanctioned. In *In re Boart Longyear*, the scheme was recognised as a foreign main proceeding *before* the Australian court had sanctioned the scheme of arrangement.[51] Given the scheme "proceeding" at the time of recognition consisted only of authorisation to hold an initial scheme creditors' meeting, a proposed scheme and a creditor vote, it may be the scheme with the least foreign court involvement of any scheme recognised to date as a foreign proceeding under Chapter 15. But it is not the only case to bifurcate a scheme proceeding and the order sanctioning a scheme of arrangement. For example, in *In re Mood Media Corp.*, the foreign representative sought *recognition* of the debtors' Canadian proceeding under section 192 of the CBCA and, separately, "enforcement of orders entered in the Canadian proceeding that approve the scheme of arrangement."[52]

It is unclear how the 101(23) factors are all present in such standalone cases, and especially how the "debtor's assets and affairs [were] subject to the control and supervision of a foreign court." Nonetheless, in the absence of objections to recognition, given the growing precedent for scheme recognition under Chapter 15, there may be no equitable reason for a court not to grant recognition even if the statutory requirements of a "foreign proceedings" are not clearly satisfied. The courts seem to have largely adopted a "no harm, no foul" approach to scheme recognition.

5. Practical guidance for practitioners

Based on the above analysis, it would be wise for insolvency practitioners to consider the strength and weakness of existing Chapter 15 jurisprudence in applying for recognition of a scheme of arrangement as a foreign proceeding under Chapter 15 – or objecting to recognition. While recognition may be the norm to date, recognition of schemes has had little meaningful testing under objection. The success or failure may depend on the factors noted herein, including:

- whether a scheme is layered on a pre-existing judicial or administrative insolvency procedure;

[45] Order Granting Petition for (i) Recognition as Foreign Main Proceedings, (ii) Recognition of Foreign Representative, and (iii) Related Relief under Chapter 15 of the Bankruptcy Code [Dkt. No. 21], *In re Edcon Holdings Ltd.*, No. 16-13475(SCC) (Bankr. S.D.N.Y. Jan. 19, 2017).
[46] *In re Cell C Proprietary Ltd.*, 571 B.R. 542, 544-45 (Bankr. S.D.N.Y. 2017).
[47] *Id.* at 545.
[48] *Id.* at 546 (emphasis added).
[49] *Id.*
[50] Order Recognising (i) Australian Proceeding as Foreign Main Proceeding; (ii) Section 411(16) Order; and (iii) Petitioner as a Foreign Representative [Dkt. No. 33] ¶ 3, *In re Boart Longyear Ltd.*, No. 17-11156 (MEW) (Bankr. S.D.N.Y. May 22, 2017).
[51] *See* Order Recognising (i) Australian Proceeding as Foreign Main Proceeding; (ii) Section 411(16) Order; and (iii) Petitioner as a Foreign Representative [Dkt. No. 33] ¶ 13, *In re Boart Longyear Ltd.*, No. 17-11156 (MEW) (Bankr. S.D.N.Y. May 22, 2017).
[52] *In re Mood Media Corp.*, 569 B.R. 556, 558 (Bankr. S.D.N.Y. 2017) (recognising the foreign main proceeding as to the parent debtor but not as to its U.S. subsidiaries).

- the likelihood of parties in interest objecting in U.S. proceedings;
- the degree of court oversight and involvement in a given scheme;
- the extent that a scheme is in fact collective in nature, such that all parties in interest receive notice and have an opportunity to object;
- the availability of other proceedings under the circumstances; and
- the likely outcome for the debtor and its stakeholders if recognition is denied.

A scheme is most likely to be enforceable where it constitutes an ancillary procedure to be enforced in connection with a foreign proceeding recognised under Chapter 15 – instead of a proceeding to be recognised independently. Where there is no layering, debtors must consider the potential weakness of their position in satisfying the seven criteria. To withstand potential objections from parties in interest, the debtor's affidavit in support of a Chapter 15 petition seeking recognition of a scheme should demonstrate that the particular scheme in question proposes a global, "collective" restructuring and should specify how the foreign court – even if indirectly – ultimately exercises supervision and control over the affairs and assets of the debtor (for example, something more substantive that declaring "yea" or "nay" in determining whether to sanction a scheme).

Conversely, in the absence of layering, parties in interest objecting to recognition may be wise to focus on the limitations of the proposed scheme, if applicable, to provide notice to general unsecured creditors or resolve their claims, highlight any classes of creditors or interest holders that may not have been included in – or have recourse to the foreign court in connection with – the proposed scheme. Moreover, such objecting parties may find their attack best directed at the potential lack of control and supervision that the foreign court has over the assets and affairs of the debtor by contrasting the minimal court involvement in scheme proceedings to the more robust control and supervision exercised in more traditional insolvency procedures.

Even if existing precedent may be built on weak foundation, foreign representatives will nonetheless want to reiterate, where applicable, that other bankruptcy courts have already considered a scheme of arrangement under the particular foreign law and concluded that such proceeding is a foreign proceeding. Objectors will want to explain the nuance of foreign scheme of arrangement statutes, demonstrating the broad range of potential arrangements that may not satisfy 11 U.S.C. § 101(23) and highlighting any facts to distinguish the proceeding in question from those previously recognised (including an indication where relevant that prior decisions merely relied on an assumption under 11 U.S.C. § 1516(a) that the scheme was a foreign proceeding). U.S. bankruptcy courts are courts of equity and generally sympathetic to a debtor's plight. Although a given scheme may not fit squarely within the definition of "foreign proceeding", the foreign representative can paint the facts to demonstrate that a scheme of arrangement was the debtor's only hope, that refusal to recognise the scheme will likely endanger the entire restructuring, and that recognition would in no way be harmful to the public policy of the United States.

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