HARNEYS

Schemes: Recognition or parallel schemes of arrangement

In response to the turbulent economic times seen of late, there has been a significant growth in the use of schemes of arrangement to compromise creditors' claims where the company in question is facing financial difficulty.

This article discusses the circumstances in which an offshore debtor, whose debts are for example governed by the laws of Hong Kong SAR, may consider to implement a parallel scheme of arrangement in its jurisdiction of incorporation and in the jurisdiction concerning its debt obligations, as an alternative to commencing recognition proceedings in Hong Kong to sanction a "foreign" scheme of arrangement.

Offshore debtor with Hong Kong law governed debt obligations: Why Is Hong Kong law relevant?

Both the BVI and the Cayman Islands have statutory regimes for the implementation of schemes of arrangement, the detailed procedures of which are similar to many common law jurisdictions but are beyond the scope of this article. The efficacy of a scheme of arrangement for an offshore debtor that is subject to debt obligation governed by the laws of Hong Kong SAR and no doubt operations and assets worldwide, will however depend upon the recognition (or not) of the proposed scheme in jurisdictions where creditors may bring claims against the debtor.

This can be of particular importance because a foreign compromise does not necessarily discharge a debt unless it is discharged under the law governing the debt (*LDK Solar Co Ltd (in provisional liquidation)* HCMP 2215/2014). In a creditors' scheme which seeks to vary contractual rights, the international effectiveness of the scheme may require that the debtor seek not only the sanction of the court in its country of incorporation, but also of the court in the country that governs its contractual debt obligations, to ensure that dissenting creditors cannot enforce their claims against the debtor's assets in countries other than that of its incorporation (*Re Drax Holdings Ltd* [2004] 1 WLR 1049).

The Hong Kong Courts' jurisdiction to sanction "foreign" schemes of arrangement

The Hong Kong courts have jurisdiction to sanction a scheme of arrangement in respect of a foreign company if there is a "*sufficient connection*" with Hong Kong to justify the Hong Kong courts sanctioning a scheme. However, the Hong Kong courts have not set out any single criterion that is to be regarded as being an essential precondition for satisfying the "sufficient connection" test. Rather, it is a matter of judgment to be made in light of the evidence presented to the court and in light of the object and purpose of the jurisdiction to be invoked.[1]

The court will also take into account other factors such as whether it is likely that the scheme will achieve its purpose. The courts may ask, for example, whether the scheme will be effective in practice to bind creditors opposing a variation of their rights; or whether the scheme will have "substantial effect" (*Re Magyar Telecom BV* [2014] BCC 448). In considering whether the scheme will serve its purpose, the courts will also consider whether the scheme will be recognised in the jurisdictions in which, for example, the substantial assets of the company are located. A further consideration is whether sanctioning the scheme will foster comity.[2]

Recognition of the scheme in other jurisdictions

Recognition of a creditor scheme in relevant jurisdictions is of significant importance to ensure that creditors cannot take unilateral action against a debtor's assets in those jurisdictions. In determining whether the BVI and the Cayman Islands will recognise schemes sanctioned by a foreign court, such recognition will depend upon principles of comity with reference to the facts of a particular case. The BVI and the Cayman Islands are likely to follow the English conflicts of law rules regarding the variation and discharge of an obligation, namely, that the BVI courts and the Cayman Islands' courts will likely only recognise the variation or discharge of an obligation or right if it has been

[1] See *LDK Solar Co Ltd (in provisional liquidation)* HCMP 215/2014. See also *Re Drax Holdings Ltd* [2004] 1 WLR 1049 and *Re Rodenstock GmbH* [2011] Bus LR 1245), where the High Court of England and Wales deemed there was a "*Sufficient connection*" with England and Wales where key finance documents were governed by English law

[2] See *LDK Solar Co Ltd (in provisional liquidation)* HCMP 2215/2014

done in accordance with the law governing those obligations or rights, although the point does not appear to have been tested in either jurisdiction.[3]

Recognition in the BVI

The recognition of a scheme sanctioned by a foreign court in the BVI, whether dealing with a BVI company or a foreign company, is untested. Part XIX of the BVI's Insolvency Act 2003 provides a framework enabling the BVI Court to provide assistance in foreign insolvency proceedings in relation to BVI companies or assets of a foreign company subject to BVI law or held within the BVI. Part XIX operates on an application-by-application basis for assistance and merely gives a foreign representative an express right to apply to the court for orders in aid, but without conferring status.[4] Part XIX allows a foreign representative from certain jurisdictions (including Hong Kong) who has been appointed as a result of foreign proceedings to apply to the BVI court for assistance.

However, a foreign representative must be "*authorised in a foreign proceeding to administer the reorganisation or the liquidation of the debtor's property*". And, "*foreign proceeding*" is defined as a "*collective judicial or administrative proceeding . . . pursuant to a law relating to insolvency in which proceeding the property and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization, liquidation or bankruptcy . . .*" (emphasis added). Depending upon the facts of the case, it is arguable that the BVI Court would accept that a Hong Kong-sanctioned scheme is for the purpose of reorganisation and/or liquidation. That said, the assistance offered under Part XIX requires an application to be made by a foreign representative and therefore, whether an order sanctioning a Hong Kong scheme would be made would likely be dependent upon whether some form of scheme administrator will be recognised under Part XIX and offered assistance thereunder.

A recent offshore example of recognition

The decision in *In the Matter of Contel Corporation Limited* [2011] SC (Bda) 14 Com, a recent Bermudan case, suggests that schemes of arrangement relating to a local company but sanctioned by a foreign court are comparatively rare in the offshore world. Indeed, it appears to be the first time the Supreme Court of Bermuda had been asked to recognise a scheme of arrangement in respect of a local company in circumstances where a parallel scheme had not been implemented.

The Bermuda court was asked on an *ex parte* application to recognise a scheme of arrangement in respect of a Bermudan-incorporated company listed on the Singapore Stock Exchange which had been sanctioned by the Singapore courts. The Bermuda court recognised the scheme, relying upon the "*extremely wide*" common law discretionary power to recognise foreign restructuring orders made in respect of local companies referred to by Lord Hoffmann in *Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508.[5]

Re Contel suggests however that the court of the home jurisdiction will not merely "rubber stamp" a scheme sanctioned by a foreign court. Rather, Kawaley J considered whether the compromise was permitted under Bermuda law (in this case, a debt for equity swap), noting that the requisite statutory majorities were the same in Singapore and Bermuda and also appeared to be influenced by the fact that although there was no parallel scheme, it did not appear to be a deliberate attempt to avoid any consequences of Bermudan law which might be more favourable to the creditors concerned.

A parallel scheme of arrangement?

As both the BVI and Cayman Islands have similar legislative corporate restructuring mechanisms, distressed companies can consider bringing parallel schemes in their home jurisdiction and in the jurisdiction governing the obligations that are to be varied or discharged by the scheme. Such schemes are generally inter-conditional in that they only take effect if the other scheme is also sanctioned by the court. The restructuring of LDK Solar Co. Ltd is regarded as the first judicially-approved, multi-jurisdictional debt restructuring of a China based group with two schemes of arrangement being sanctioned by the Grand Court of the Cayman Islands, three schemes of arrangement being sanctioned by the Hong Kong Courts, a plan approved under Chapter 11 of the US Bankruptcy Code as well as an application under Chapter 15 of the US Bankruptcy Code for recognition of the Cayman scheme.

Parallel schemes have a number of advantages in that there will be no question that the variation of debt obligations by the Hong Kong courts is valid and enforceable; the debtor company will have comfort that its domestic legislation has

[3] See rule 219 of Dicey, Morris & Collins, *The Conflict of Laws* (Fifteenth Edition); *Gibbs & Sons v Societe Industrielle et Commerciale des Metaux* (1890) LR 25 QBD 399 (CA) upheld in by the English Court of Appeal in *Global Distressed Alpha Fund 1 Ltd Partnership v PT Backrie Investindo* [2011] 1 WLR 2038)

[4] *Irving H Picard v Bernard L Madoff Investment Securities LLC* (BVIHCV 0140/2010

[5] However, note the decision of the Supreme Court in *Rubin & Anor v Eurofinance et al* [2013] 1 AC 236 which considered that Cambridge Gas had been wrongly decided on the question of whether the Manx court had the jurisdiction to order recognition of a plan sanctioned under Chapter 11 of the US Bankruptcy Code. Note also the more recent decision of the Privy Council in *Singularis Holdings Limited v PricewaterhouseCoopers* [2015] 2 WLR 971 in which a majority upheld in theory the principle of "modified universalism" propounded by Lord Hoffmann in Cambridge Gas confirming it was part of the common law, though subject to local law and public policy and that the court may only ever act within its own statutory and common law powers

been followed such that the scheme will bind any creditors seeking to take unilateral action against it in its home jurisdiction; and the use of parallel schemes will provide further evidence to the courts sanctioning those schemes that the schemes will likely be effective and serve their purpose.

As explained above, the recognition of schemes of arrangement in the home jurisdiction of an offshore debtor is largely untested therefore a parallel scheme may maximise a scheme's efficacy and remove any risk that it will not be recognised in the country of incorporation.

Conclusion

As can be seen, it is imperative that any restructuring strategy considers not only the jurisdiction of the governing law of the contractual obligations but also of the place of incorporation and potentially the jurisdictions in which substantial assets are located. The careful planning of cross-

This article is not exhaustive and has been prepared to give an outline of considerations to be taken into account when implementing schemes of arrangement with an offshore element; it should not be taken as a substitute for legal advice.

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