Briefing

Corporate Turnaround and Insolvency

BURGES SALMON

A scheme too far? Scheme of arrangement sanctioned for Dutch company with New York law governed obligations

Preamble

Most if not all of our readers will be aware of a recent spate of decisions in which the English courts have been prepared to sanction schemes of arrangements (SofAs) for foreign entities having a "sufficient connection" with England and Wales. The latest decisions in *Re Magyar Telecom B.V. (03/12/2013*) show just how flexible the English courts can be in finding such a connection.

The background

Magyar Telecom was a company incorporated in the Netherlands whose principal activity was the provision of telecommunication services in Hungary. In order to finance its activities, the company issued a series of notes in December 2009 with a value of €345 million, maturing in 2016 and bearing interest at 9.5%. The notes were governed by New York law (a non-exclusive jurisdiction clause), were guaranteed by other group members and secured by way of pledge. The notes were also held by a common depository under a global note (i.e. specific notes had not been issued to the investors who had bought them).

Magyar become unable to pay interest on the notes, and its group was unable to pay as guarantors. In order to avoid formal insolvency, the company proposed an English law SofA under which (i) new notes totalling €155 million would be issued to the **beneficial** owners of the existing notes in exchange for the surrender of rights against Magyar and its group; and (ii) the note holders would be given 100% equity in a new company set up to hold circa 50% of Magyar's share capital.

At the scheme meeting, over 97% of the attending creditors in number (representing over 99% by value of notes) voted in favour of the scheme. which was then put forward to the English courts for approval.

The issues

Despite the overwhelming creditor support for the scheme, the court still had to decide (i) whether the criteria for the Scheme under Part 26 of the Companies Act 2006 (CA 2006) had been met, and (ii) whether Magyar had a sufficient connection to the UK for the court to sanction an arrangement, given the marked foreign elements involved.

What did the court decide?

The court approved the scheme. Looking at the CA 2006 criteria, the company **was** a company liable to be wound up under the IA 1986, even though the court would not presently exercise that discretion. That was not a bar to Magyar being subject to the court's jurisdiction. Looking at the issue of creditor approval, it was noted that although the creditors voting (the beneficial note owners) were not strictly "creditors" until a specific note had been issued in their names, there were circumstances in which they could become registered as holders, and so counted as "contingent" creditors under Section 899 of CA 2006. Accordingly, the arrangement had been sanctioned by over 75% of creditors by value.

Turning to the sufficient connection issue, the court noted that the previous decisions of *Re Rodenstock, Re Primacom Holdings and Re Vietnam Shipbuilding Industry Group*, in which the court had sanctioned schemes merely on the choice of English law as governing law (whether exclusive jurisdiction or not). This case was different, given that New York law had been selected. As a result the court needed to find other reasons to establish a connection.

Looking into the company's position, the court noted that the Centre of Main Interests (of COMI) had shifted to England prior to the SofA creditors meeting being convened. As a result, it was likely that insolvency proceedings would be capable of

continued overleaf

being conducted in England. Expert evidence also showed that the Dutch, Hungarian and US courts would be likely to recognise the SofA. The SofA itself was conditional upon a recognition judgment of the US courts under Chapter 15 of the US Bankruptcy Code (although that requirement could be waived by Magyar). The conditionality aside, the court was prepared to give the scheme effect whilst an application was pending, given that an overwhelming majority of creditors has sanctioned the scheme and therefore it had already been given substantial effect. Taking into account all these factors, the court was satisfied that there was a sufficient connection of Magyar to England, justifying the sanction of the SofA. Additionally, the SofA would be entitled to recognition under Chapter II of the EC Judgments Regulation, as the exclusion of insolvency proceedings under the Regulation did not extend to SofAs. Whilst the issue of applicability of the Regulation on the court's jurisdiction to sanction SofAs was not conclusively determined, the court observed that if it did, the court would not be restricted in recognising the SofA given that a number of note creditors were domiciled in England and other note creditors located in different member states were therefore capable of being sued in England.

What does this mean for practitioners?

It will be informative to see whether this first instance decision will be challenged. Whilst previous cases (mentioned above) have found the courts willing to assume jurisdiction where English law applied to underlying obligations of a debtor, this is the first case of note where no assets or obligations of a company were subject to English law.

The court seems to have attached particular importance to the fact that the COMI of Magyar had shifted to England, as the running of insolvency proceedings here provided a solid basis for a scheme under English law. Whilst the reasoning is certainly understandable, COMI is (currently) judged at a certain point in time, which may well shift again in future. There is some suggestion from the judgment that COMI was shifted to England in anticipation of proposing a SofA, which smacks somewhat of forum shopping (see for example the decision in our April update on the *Schrade v Sparkasse Ludencheid*). At present there is no suggestion of an appeal.

Whatever the case, there is still the issue of the reforms to the EC Insolvency Regulation, which we reported on in our February briefing. Amongst the reforms are proposals to include pre-insolvency restructuring proceedings (such as SofAs) within the scope of the Regulation, and a three month look-back period on COMI. We will be following this with great interest.

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BRM0770 04 14