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Kirkland Alert

Gategroup: UK restructuring plans are insolvency proceedings; classes split

26 February 2021

At A Glance

Following the English court's judgment¹ on Gategroup's proposed restructuring plan:

1. The new UK restructuring plan procedure is likely to be held to constitute a bankruptcy/insolvency proceeding – at least for the purposes of the bankruptcy exclusion to the Lugano Convention, but likely also for other purposes, including the bankruptcy exclusion to the Hague Convention. This makes potential recognition of UK restructuring plans in Europe even more challenging; recognition is important to ensure the deal is fully binding on all stakeholders and to minimise the risk of disruptive action.
2. The use of a co-obligor structure – essentially, to engineer claims into a single entity which effects a compromise via a restructuring plan (or scheme of arrangement) – was broadly endorsed by the court, subject to limits.
3. The court ordered that the single-class structure proposed by the plan company instead be split into two classes.

The court handed down its convening judgment on 17 February. It remains to be seen whether the Gategroup bondholder class will approve the restructuring plan on 19 March and whether or not the court will sanction the plan, on or about 26 March.

This *Alert* also considers whether a scheme of arrangement constitutes an “insolvency proceeding”. This question has yet to be resolved, but we strongly believe a scheme is *not* an insolvency proceeding.

The Gategroup restructuring

Gategroup is an international airline catering services provider. The restructuring plan of Gategroup Guarantee Limited (the Company) is designed to “amend and extend” the group’s debt obligations to lenders under a €600 million senior facilities agreement and bondholders under CHF 350 million bonds, in each case for a five-year period. The restructuring plan forms part of the group’s wider financial restructuring, which includes amendments to a €475 million mezzanine facility agreement and the injection of CHF 500 million new money from the group’s shareholders.

Restructuring plans as insolvency proceedings

The court held that restructuring plan proceedings are within the bankruptcy exclusion in the Lugano Convention, i.e., effectively, that a restructuring plan is an insolvency proceeding.

To summarise a complex issue briefly:

- the bonds are governed by Swiss law and subject to the exclusive jurisdiction of the Swiss courts;
- this raised a difficult question of whether the English court had jurisdiction pursuant to the Lugano Convention² (Gategroup’s claim form was issued two days prior to the Brexit implementation date; following the end of the Brexit implementation period, the UK is no longer party to the Lugano Convention);
- if the Lugano Convention *did* apply to restructuring plan proceedings, then the Company accepted that the English court would not have jurisdiction to sanction a restructuring plan amending its Swiss law bonds; and
- accordingly, the Company contended that the Lugano Convention did *not* apply to restructuring plan proceedings, owing to an exception in the Lugano Convention for bankruptcy proceedings.³

The court examined the substance of the restructuring plan procedure from first principles. It ultimately found that restructuring plans *do* fall within the bankruptcy exception to the Lugano Convention (i.e., effectively, that they constitute an “insolvency proceeding”), principally on the grounds of the threshold conditions to eligibility for a restructuring plan, which require an element of financial difficulties.⁴

Whilst helpful for the Company’s case, this may impact the likelihood of recognition of future restructuring plans in Europe, which has become especially difficult post-Brexit

(see further [here](#)). In particular, as the law now stands and absent the judgment in *gategroup* being superseded or overturned:

- it will not be possible to rely on the Lugano Convention for recognition of a restructuring plan (even if/once the remaining EU member states consent to the UK's re-accession);
- it is unlikely to be possible to rely on the Hague Convention⁵ for recognition of a restructuring plan (given the Hague Convention contains an exclusion for "insolvency, composition and analogous matters"⁶); and
- accordingly, recognition will need to be sought on other bases, such as local recognition provisions in the domestic law of the relevant EU country (including those few EU countries that have enacted the UNCITRAL Model Law on Cross-Border Insolvency) or under the Rome I Regulation (where obligations/rights compromised under the plan are governed by English law).

Kirkland & Ellis did submit a letter to the court on these issues (to the effect that we do not consider a restructuring plan to be an insolvency proceeding), which is referenced in the judgment.

Is a scheme of arrangement an insolvency proceeding?

The longstanding prevailing view of the English courts (at least pre-Brexit) is that schemes of arrangement are *not* an insolvency proceeding.⁷ However, recent cases in the aviation sector, involving the Cape Town Convention⁸ have again raised this question. This is because, if a scheme of arrangement *is* an "insolvency-related event" under the Cape Town Convention and the related Aircraft Protocol, then the scheme company's obligations to creditors with registered aircraft interests (such as security over aircraft) cannot be modified without the consent of *each* such creditor⁹ – i.e., a debtor that has creditors with interests protected by the Cape Town Convention then could not rely on a scheme to bind any such creditor who dissents or "holds out".

The English and Irish courts narrowly avoided having to determine this question:

- in *Nordic Aviation*¹⁰, the Irish court noted that the company had made a "strong case" that its Irish scheme did *not* constitute an insolvency-related event for the purposes of the Cape Town Convention and the related Aircraft Protocol, though it ultimately found it unnecessary to determine the matter, on the basis that none of the scheme creditors opposed the scheme; and

- in *MAB Leasing*¹¹, the same issue arose but was again unnecessary for the English court to determine because ultimately every scheme creditor approved the scheme. However, the court indicated it considered there was very strong reason to think that a scheme does *not* amount to an insolvency-related event.¹²

In contrast, the Malaysian High Court has just ruled that a Malaysian scheme of arrangement *is* an insolvency-related event for the purposes of the Cape Town Convention.¹³

We remain firmly of the view that a scheme of arrangement ought *not* to constitute an insolvency-related event, consistent with the long-standing approach to schemes over the last ten years (and noting the court in *gategroup* held that the "financial difficulties" threshold conditions for a restructuring plan¹⁴ constituted a material distinction between restructuring plans and conventional schemes¹⁵). We are happy to discuss this further with interested clients.

Co-obligor structure and class constitution

Gategroup's restructuring plan utilised a "co-obligor" structure, in this case to avoid triggering an event of default under the bonds. This technique has been used in an increasing number of recent schemes of arrangement and in PizzaExpress' restructuring plan (in which Kirkland represented the PizzaExpress group). In summary, this involved:

- the incorporation of the Company (an English newco), which then executed a deed of indemnity and contribution (the Deed Poll) in favour of the senior lenders and the bondholders;
- the Company then proposing the restructuring plan, which seeks to compromise the claims of the senior lenders and the bondholders against the Company under the Deed Poll and (by extension) the creditors' claims against the original obligors; and
- Gategroup also moved the centre of main interests of the bond issuer to England.

The judgment broadly endorsed the use of this co-obligor structure, notwithstanding the element of "artificiality", on the basis of a lack of realistic alternatives to effect Gategroup's restructuring (the alternative being value-destructive liquidation). (The court in *Smile Telecoms*¹⁶ (Trower J) affirmed the approach taken on this point in *gategroup*, in a case involving a guarantor proposing the restructuring plan.) The use of the Deed Poll was an "essential component" of the restructuring.¹⁷

However:

- the court in *gategroup* noted it was possible to imagine uses of the co-obligor structure that would be wholly objectionable, such as “where it unfairly overrode legitimate interests of creditors pursuant to the contracts governing their relationship with the primary obligor companies or under the system of law, including relevant principles of insolvency law, which applies to the relationship between them” or “where the attempt to compromise plan creditors’ rights against third parties was bound to fail because that compromise would not be recognised in any of the relevant foreign jurisdictions where it mattered”;
- the judgment does not resolve the difficult question of what happens if a creditor purports to disclaim the relevant deed poll (as an opposing creditor had done in this case, before withdrawing its opposition and its disclaimer); and
- the court decided to split the creditor classes into two, as explained below.

Counsel for the Company had argued that the senior lenders and the bondholders should vote together in a single class. However, the court ordered that they should vote in two separate classes, on the basis that:

- the plan creditors were creditors of the Company solely by virtue of the Deed Poll (and an associated contribution payment agreement) and none of the plan creditors had a genuine economic interest in the Company (or in its hypothetical liquidation), because the Company had no assets other than the right to require other group entities to satisfy their obligations. Accordingly, in substance, plan creditors would be reliant for any recovery on the obligors under the senior facilities agreement and the bonds (respectively);
- it was necessary to look through the “artificial structure” in this case: the lenders “clearly” had different rights to the bondholders, principally by reason of the different identity of the obligors under the senior facilities agreement and the bonds (respectively); and
- further, the rights conferred by the plan on the lenders were different to the rights conferred on the bondholders (again, principally because the principal claims were against different entities).

Accordingly, the rights of the lenders and the bondholders were “so dissimilar as to make it impossible for them to consult together with a view to their common interest” and needed to constitute separate classes.¹⁸

Had the Company proposed a conventional scheme of arrangement rather than a restructuring plan, the court’s decision would have effectively granted a right of veto

to the bondholder class (because the senior lenders have entered into a lock-up agreement, but the bondholders have not, and a conventional scheme of arrangement requires the requisite majority of *every* class to vote in favour). However, in a restructuring plan, a court may sanction a plan to which not all classes have consented, subject to certain conditions.

Kirkland recently advised the DeepOcean group on the first ever “cross-class cram-down” under a UK restructuring plan; see further [here](#). It remains to be seen whether the Gategroup bondholder class will approve the plan at the meeting on 19 March 2021 (and therefore whether the court will be asked to sanction a plan to which not all classes have consented).

Next steps

Stakeholders will vote on the plan on 19 March, as noted; the sanction hearing is expected on or about 26 March.

1. *Re gategroup Guarantee Limited* [2021] EWHC 304 (Ch) [↔](#)

2. The Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial matters, signed in Lugano on 30 October 2007 (the Lugano Convention) [↔](#)

3. Specifically: “bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings” – Article 1(2)(b) of the Lugano Convention [↔](#)

4. Section 901A of the Companies Act 2006 requires that the company has encountered, or is likely to encounter, financial difficulties that will or may affect its ability to carry on business as a going concern *and* that any plan must be one that seeks to eliminate, reduce or prevent, or mitigate the effect of, those financial difficulties. [↔](#)

5. Convention on Choice of Court Agreements, concluded in The Hague on 30 June 2005 (the Hague Convention) [↔](#)

6. Article 2(2)(e) of the Hague Convention [↔](#)

7. E.g., *Re Magyar Telecom BV* [2014] BCC 448; *Re Rodenstock GmbH* [2012] BCC 459; *Re Van Gansewinkel Groep BV* [2015] EWHC 2151 (Ch) [↔](#)

8. The Convention on International Interests in Mobile Equipment, signed in Cape Town on 16 November 2001, and the protocol to that convention; implemented in English law by The International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 [↔](#)
9. Subject to how relevant jurisdictions have implemented the Cape Town Convention and the related protocol and whether the parties have excluded the application of the usual “remedies on insolvency” in their agreement. [↔](#)
10. *Re Nordic Aviation Capital Designated Activity Company* IEHC [2020] 445 at [162]-[164] [↔](#)
11. *Re MAB Leasing Ltd* [2021] EWHC 152 (Ch) and [2021] EWHC 379 (Ch) [↔](#)
12. *Re MAB Leasing Ltd* [2021] EWHC 152 (Ch) at [45] and in the scheme sanction hearing on 22 February [↔](#)
13. *Re AirAsia X Berhad*, in the High Court of Malaya in Kuala Lumpur, in the Federal Territory, Malaysia (Commercial Division), originating summons no.: WA-24NCC-467-10/2020; judgment handed down 19 February 2021 [↔](#)
14. See footnote 4 above [↔](#)
15. *Re gategroup Guarantee Limited* [2021] EWHC 304 (Ch) at [102] [↔](#)
16. *Re Smile Telecoms Holdings Ltd*; convening hearing 19 February 2021 [↔](#)
17. *Re gategroup Guarantee Limited* [2021] EWHC 304 (Ch) at [179] [↔](#)
18. Under the traditional test for class constitution for a scheme of arrangement, as formulated in *Re Hawk Insurance Company Ltd* [2001] EWCA Civ 241. [↔](#)

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Related Services

Practices

- Restructuring

Suggested Reading

- 28 January 2021 Kirkland Alert The First UK Cross-Class Cram-Down
- 10 December 2020 Kirkland Alert UK Temporary Restructuring/Insolvency Measures – Certain Measures Extended or Reinstated
- 30 November 2020 Kirkland Alert Return of UK Tax Authority as Preferential Creditor in UK Insolvency Proceedings Takes Effect 1 December 2020

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