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Expert Analysis

'Codere': a New Model For Cross-Border Restructurings

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Multinational companies in financial distress—including companies based outside the United States, but with debt governed by New York law—face difficult choices in determining where to restructure their debts. This is especially true for companies in jurisdictions without established or effective regimes for complex debt reorganizations. For some time, the "COMI shift"—i.e., moving the company's "center of main interest"—has been a strategy of choice, with England as the preferred destination and the "scheme of arrangement" in the United Kingdom (often combined with a chapter 15 proceeding in the United States) as the ultimate legal mechanism to achieve a balance-sheet restructuring.

While a COMI shift remains a viable route to access a UK scheme, the recent restructuring of Codere, a large multinational gaming company, presents an alternative method that in some cases will be more efficient and straightforward—namely, the addition of a UK-based co-obligor on the debt to be restructured. As described below, the co-obligor approach permits a non-UK company to access a UK scheme of arrangement, followed if necessary by a U.S. chapter 15, without the complexities and risks associated with a full-scale COMI shift. Companies in distress, especially European companies with debt governed by New York law and a mix of UK and non-UK creditors, can and should consider the creation of a co-obligor as an alternative to a COMI shift.

UK Schemes of Arrangement

A scheme of arrangement (or scheme, for short) is a court-supervised, statutory procedure in the United Kingdom that enables a company to make an arrangement, or compromise, with its creditors which, if approved by the requisite majority (75 percent in value and a majority in number of each affected class) and sanctioned by the court, will bind all such creditors, including any dissenters or holdouts.[1] As reflected by various recent cases, a scheme is an effective way to implement a multinational group-wide balance-sheet restructuring where creditor support is less than unanimous.

> While a COMI shift remains a viable route to access a UK scheme, an alternative method that in some cases will be more efficient and straightforward is the addition of a UK-based co-obligor on the debt to be restructured.

A number of features enhance the attractiveness of schemes as vehicles for restructurings. Schemes may be used to restructure secured or unsecured debt (or both at once), which may not be the case for other available restructuring processes.[2] Third-party releases are routinely granted as part of UK schemes where the court concludes that they are necessary to the success of the restructuring. In addition to offering comfort to directors and managers, such releases are used to facilitate the discharge of co-obligors or guarantors of the restructured liabilities, without requiring those co-obligors to file their own schemes.

Liabilities owed to creditors not targeted by the scheme remain intact and are unaffected. Moreover, a scheme is technically not an insolvency proceeding, thus avoiding the stigma and consequences (regulatory, contractual or otherwise) of insolvency. In contrast, U.S. bankruptcy law is more restrictive in permitting third-party releases, and a U.S. chapter 11 case would likely be considered an insolvency proceeding. Finally, UK schemes are known to be quick and efficient. It is not uncommon for a scheme with strong creditor support to proceed from an initial convening hearing to final court approval in less than two months.[3]

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The COMI Shift

English courts have jurisdiction to sanction schemes involving companies that can be wound up under the Insolvency Act 1986.[4] Although "the High Court has jurisdiction to wind up any company registered in England and Wales,"[5] a foreign company generally must have a "sufficient connection" with the UK in order to be eligible. Where the relevant debt documents are governed by English law and the majority of creditors are located in the UK, establishing a foreign borrower's "sufficient connection" to the UK may be straightforward. On the other hand, where the connections are more attenuated—including where non-UK borrowers have sought to restructure debts governed by New York law—COMI shifts have been a preferred means of establishing jurisdiction in the UK

To move its "center of main interest," a company typically must take steps that are both time-consuming and expensive. For instance, in preparation for its 2013 scheme, Magyar Telekom B.V. (incorporated in the Netherlands and operating principally in Hungary) opened a new office in the UK, announced that office as its new headquarters, held board meetings and creditor negotiations in London in the months leading up to the scheme, ensured that a majority of its board members were UK residents, moved its books and records to London, registered as a UK tax resident, contracted for corporate services from UK firms and began sending and receiving mail and fax correspondence primarily in the UK.[6] In addition to the costs, these measures can have unintended consequences—for example, affecting the company's taxation, its legal status and its relationships with regulators in its former home jurisdiction, and possibly violating contracts. Moreover, even after such measures are taken, there can be doubt as to the effectiveness of a COMI shift, since no one fact or action will be dispositive in establishing the new COMI.

Creation of New UK Obligor

The recent Codere case presents an alternative route to establishing scheme jurisdiction. In particular, rather than undertaking a COMI shift, Codere incorporated a new subsidiary in the UK—Codere Finance (UK) Limited (Codere UK)—that assumed primary obligations on existing debts and became the debtor in the UK scheme proceeding.

Codere SA is a Spanish multinational gaming company with operations in numerous countries, including Argentina and Mexico. In 2015, a newly created subsidiary of Codere SA sought and obtained approval of a scheme of arrangement to restructure $1.214 billion in debt under two series of secured notes. The notes were originally issued by Codere's main finance subsidiary, based in Luxembourg, and guaranteed by various subsidiaries of Codere around the world. Although Codere SA is based in Spain, and the original issuer was based in Luxembourg, neither of these entities moved its COMI to the UK. Instead, Codere amended the indentures governing its secured notes to add Codere UK as an additional, primary obligor. Codere UK then applied for a scheme of arrangement.

In sanctioning the scheme, Judge Guy Newey of the UK's High Court of Justice, Chancery Division, noted that "over recent years the English courts have become comfortable with exercising the scheme jurisdiction in relation to companies which have not had longstanding connections with this jurisdiction," a trend he extended to the Codere case, in which the entity subject to the scheme was formed "only recently, and with a view to invoking the scheme jurisdiction."[7] Although the scheme was put forth by Codere UK, as in the case of other schemes, it was effective to restructure the debt of the group as a whole because it included a release and cancellation of the secured notes as against not only Codere UK, but also against the initial Luxembourg issuer and guarantors.

Compared to shifting the COMI of an existing obligor, Codere's approach of adding a new UK obligor to the debt being restructured had a variety of advantages. To start with, it could be achieved quickly and without the expense of a COMI shift. Codere caused the incorporation of a UK subsidiary, acquired the subsidiary and (as permitted by the governing indenture) caused the subsidiary to enter into appropriate documentation to accede as an obligor on the debt.[8] In addition, unlike the COMI-shift approach, in which no one fact or action will guarantee a "sufficient connection" to the UK for scheme jurisdiction, a scheme that formally involves a UK obligor gives the UK court a more straightforward statutory basis to exercise jurisdiction since the company is expressly eligible to be wound up under the Insolvency Act 1986.[9] Finally, there was no disruption of the initial Luxembourg issuer's legal status or relationships with its regulators.

Where the relevant debt is governed by New York law, as is the case for many issuers with limited connections to New York, the issuer, its creditors or the UK court may require that effectiveness of the scheme be conditioned on a U.S. bankruptcy court recognizing the scheme as a "foreign main proceeding" pursuant to chapter 15 of the U.S. Bankruptcy Code. Under chapter 15, a "foreign main proceeding" is a foreign restructuring proceeding "in the country where the debtor has the center of its main interests,"[10] and following a decision of the U.S. Court of Appeals for the Second Circuit in *In re Fairfield Sentry*, the appropriate time for determining the debtor's center of main interest is upon filing of the chapter 15 petition.[11]

Both the COMI shift and Codere approaches would generally result in the debtor having its COMI in the UK at the time the chapter 15 petition is filed (typically, shortly after the UK convening hearing). But the Codere approach offers an added benefit in the form of a statutory presumption: Under §1516(c) of the Bankruptcy Code, the debtor's "registered office"—i.e., its place of incorporation—is "presumed to be the center of the debtor's main interests."[12] A UK co-obligor will benefit from this presumption, but an existing obligor that shifts its COMI to the UK to establish jurisdiction for a scheme will not, unless it also reincorporates in the UK. Codere UK benefited from this presumption when its scheme was recognized as a "foreign main proceeding" by the Bankruptcy Court for the Southern District of New York.[13]

Looking Forward

The recent Codere case offers distressed foreign companies an alternative approach for accessing a UK scheme of arrangement to complete a financial restructuring. It remains to be seen whether the Codere approach will become the new standard and whether, in contentious cases that involve creditor opposition (unlike the Codere scheme, which had near-unanimous creditor support), the addition of a new UK co-obligor will satisfy the UK court (or a U.S. bankruptcy court) that the debtor group's newly-created UK contacts are sufficient.

Additionally, although UK courts have taken the lead in attracting international restructurings, it is only a matter of time before other countries consider statutes similar to UK schemes. For example, in the United States, the National Bankruptcy Conference, an organization comprised of leading practitioners, recently published a proposal to add a new chapter 16 to the Bankruptcy Code that would facilitate restructuring of bond and credit agreement debt.[14] At this time, however, the UK scheme continues to be perceived as an efficient mechanism for balance-sheet restructurings, and the advent of the Codere approach may only increase its advantages.

1. See UK Companies Act 2006, Part 26, available at http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf.
2. For example, Magyar Telekom, incorporated in the Netherlands, shifted its COMI to the UK in 2013 in order to use a scheme of arrangement to restructure its secured bonds because a local restructuring process, the Dutch Akkoord, was only available for unsecured debt. See *Magyar Telecom B.V.*, Re [2013] EWHC 3800 (Ch).
3. See, e.g., *Magyar Telecom B.V.* [2013] EWHC 3800 (Ch) (32 days from scheme convening hearing to sanction); *Zlomrex International Finance S.A.* [2013] EWHC 3866 (Ch) (49 days); *New World Resources NV* [2014] EWHC 3143 (Ch) (38 days).
4. UK Companies Act 2006, Part 26, §895(2)(b).
5. Insolvency Act 1986, Part IV, Chapter VI, §117(1).
6. Verified Petition for Recognition of Foreign Main Proceeding, *In re: Magyar Telecom B.V.*, ECF No. 2, Case No. 13-13508 (SHL) (Bankr. S.D.N.Y. Oct. 29, 2013).
7. *Codere Finance (UK) Limited*, Re [2015] EWHC 3778 (Ch).
8. A typical indenture provision allows the issuer and the trustee, without the consent of noteholders, to make any change that does not adversely affect the rights of any noteholder, such as adding an additional obligor. See Revised Model Simplified Indenture (1999) §9.01, 55 Business Lawyer 1115 (May 2000). Even if this provision is not present or is deemed inapplicable, an amendment to add an additional obligor may require only majority consent, which should be achievable if the scheme itself has the requisite noteholder support.
9. See supra n. 5.
10. 11 U.S.C. §1502.
11. *Morning Mist Holdings Ltd. v. Krys* (*In re Fairfield Sentry Ltd.*), Case No. 11-4376, 2013 WL 1593348 (2d Cir. April 16, 2013).
12. 11 U.S.C. §1516(c).
13. Order Granting Petition for Recognition of Foreign Main Proceeding and Request for Related Relief, ECF. No. 16, *In re Codere (UK) Limited*, Case No. 15-13017 (Bankr. S.D.N.Y., Dec. 22, 2015) ("The UK Proceeding [the scheme] is pending in England (a constituent member of the political union comprising the UK), which is the country in which the Debtor [Codere UK] has the center of its main interests and, as such, the UK Proceeding is a 'foreign main proceeding' within the meaning of sections 1502(4) and 1517(b)(1) of the Bankruptcy Code and entitled to recognition as the foreign main proceeding in respect of the Debtor.")
14. See http://newnbc.wpengine.com/wp-content/uploads/2015/07/Proposed-Amendments-to-Bankruptcy-Code-to-Facilitate-Restructuring-of-Bond-and-Credit-Agreement-Debt.pdf.

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