WILLIAM FRY // Litigation & Investigations

Landmark scheme of arrangement to restructure US$1.65 billion of senior debt sanctioned by the Irish High Court

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INTRODUCTION

William Fry recently advised Ballantyne Re plc ("**Ballantyne**"), an Irish reinsurance SPV, on the approval and implementation of an Irish law scheme of arrangement with its senior noteholders to restructure its reinsurance obligations and outstanding New York law governed indebtedness such that the residual value in the company could be distributed to its senior noteholders (the "**Scheme**").

Certain of Ballantyne's senior debt was guaranteed by third parties and the Scheme provided for the commutation of the obligations of the largest guarantor and the preservation of the obligations of a second guarantor until the original maturity of Ballantyne's senior debt in 2036.

The sanction of the Scheme by the Irish High Court was opposed by one of Ballantyne's senior noteholders with a relatively minor holding (US$5m par value of senior debt). Following a contested hearing before Mr Justice Barniville on 5 June 2019 a detailed judgment, in which Mr Justice Barniville considered and approved a number of Irish and international authorities on schemes of arrangements, was delivered on 6 June 2019. The judgment rejected all of the grounds of objection and sanctioned the Scheme. In doing so the judgment considered important concepts such as the applicable test when sanctioning a scheme, the ability of an Irish scheme to restructure New York law governed debt and whether an Irish law scheme could provide for third party releases.

Following the sanction of the Scheme and in order to ensure the effective implementation of the Scheme Ballantyne sought and obtained recognition of the Scheme under Chapter 15 of the US Bankruptcy Code on 11 June 2019. Davis Polk & Wardwell LLP advised Ballantyne on the Chapter 15 application and US aspects of the restructuring with PwC (Ireland) acting as financial advisors to the company.

This case not only demonstrates the effectiveness of Irish schemes of arrangement (which have been on the statute books for over 50 years but have principally been used in recent decades for solvent restructurings and takeovers) as a tool to implement complex international debt restructurings but also the effectiveness and robustness of Ireland as a jurisdiction in which to pursue such restructurings.

BACKGROUND

Ballantyne was an Irish reinsurance SPV incorporated in 2006 for the purpose of entering into and performing an indemnity reinsurance agreement relating to a defined block of life insurance policies. In order to fund its obligations under the indemnity reinsurance agreement Ballantyne issued the senior notes (Class A) and junior notes (Classes B, C and D) in the total amount of c. US$1.92 billion and engaged a third party as investment manager for the funds raised from the issuance of the notes.

Approximately 95% of the funds raised by issuance of the notes were invested in subprime and Alt-A securities which experienced c. $1billion of losses between May 2006 and October 2008. The investment losses incurred between 2006 and 2008 effectively eliminated the economic value in the junior notes, significantly impacted the assets available to discharge Ballantyne's obligations under the senior notes and gave rise to ongoing events of default.

Certain of the senior notes were guaranteed by Ambac Assurance UK Limited ("**Ambac**") (par value US$900million) and Assured Guaranty (UK) plc (and ultimately other Assured Guaranty group entities) ("**Assured**") (par value US$500million) in respect of scheduled interest and principal.

Following the settlement of litigation against the third party investment manager and discussions with certain senior noteholders Ambac (as the largest guarantor) proposed a restructuring to Ballantyne. Having considered the restructuring proposal, Ballantyne concluded that the proposed restructuring was in the best interests of Ballantyne's creditors as a whole, including the senior noteholders, and determined to proceed with the restructuring to be implemented through an Irish law scheme of arrangement.

WHAT IS A SCHEME OF ARRANGEMENT UNDER IRISH LAW?

Part 9 of the Irish Companies Act 2014 (the "**2014 Act**") provides for a "company" to enter into a compromise or arrangement with (a) its creditors or any class of them or (b) its members or any class of them. A scheme of arrangement is an extremely flexible tool and can facilitate a broad range of possible compromises or arrangements between a company and its creditors or members.

It is separate and distinct from the examinership process under Irish law (and the form of schemes of arrangement used within that process) and its deployment neither requires that a company is (or is likely to be) insolvent nor that the company has a reasonable prospect of survival if it is insolvent.

In order for a scheme of arrangement under Part 9 of the 2014 Act to take effect:

1. the scheme of arrangement must be approved by a special majority (a majority in number representing 75% or more in value of the creditors/members present and voting) at the required meetings of classes of creditors/members;
2. notice of the passing of such resolutions at the scheme meeting(s) and that an application will be made to the High Court to sanction the scheme of arrangement; and
3. the High Court must sanction the scheme of arrangement.

A "company" in this context means any company liable to be wound-up under the 2014 Act and therefore includes any company, Irish or non- Irish, with a sufficient connection to Ireland. In this instance Ballantyne was an Irish incorporated public limited company.

PROPOSED RESTRUCTURING OF BALLANTYNE

The proposed restructuring involved:

1. the novation of the indemnity reinsurance agreement to Swiss Re Life and Health America Inc.;
2. the disbursement of residual assets following the novation to pay a dividend to senior noteholders (ultimately in the amount of US$0.512 per US$1.00 of senior debt);
3. the 'turnover' of a portion of the residual assets payable to senior noteholders to fund:
    a. a lock-up fee of US$0.0125 per $1.00 of senior debt payable to qualifying noteholders;
    b. the costs of the restructuring (including certain third party costs);
    c. the acquisition of a specified cause of action from Ambac; and
    d. a holding period trust structure;
4. the creation of a holding period trust structure to, amongst other things, facilitate the distribution of deferred consideration to senior noteholders, provide a mechanism to preserve the guarantees provided by Assured until maturity, fund the liquidation of the company and take an assignment of the above-mentioned cause of action for the potential benefit of the senior noteholders;
5. the commutation of the guarantee obligations of Ambac in return for a commutation payment;
6. the release of any claims of the senior noteholders against the various released parties (including, among others, Ballantyne, Ambac and third party advisors);
7. the release of any claims of each Ambac Guaranteed Noteholder (defined below) against Ambac (in its capacity as financial guarantor);
8. the release of any claims of any of the financial guarantors against Ballantyne; and
9. the subsequent solvent liquidation of Ballantyne.

APPROVAL BY SENIOR NOTEHOLDERS

Following an order of the Irish High Court (Commercial) on 29 April 2019 two scheme meetings were convened for 22 May 2019. The scheme meetings comprised a meeting of senior noteholders who held notes guaranteed by Ambac (the "**Ambac Guaranteed Noteholders**") and a meeting of the senior noteholders who held notes guaranteed by Assured and the senior noteholders who held notes that were not guaranteed by any third party (the "**Assured Guaranty/A-1 Noteholders**").

Ambac Guaranteed Noteholders representing 98.12% by value present and voting at the first scheme meeting (consisting of 10 out of the 15 Ambac Guaranteed Scheme Noteholders present and voting) approved the Scheme whereas 100% by number and value of the Assured Guaranty/A-1 Noteholders present and voting at the second scheme meeting approved the Scheme.

APPLICATION TO SANCTION THE SCHEME

Shortly after the passing of the resolutions to approve the Scheme, Ballantyne issued an application to the Irish High Court (Commercial) for an order sanctioning the Scheme.

That application was opposed by a single senior noteholder, ESM Fund I, LP ("**ESM**"), who held US$5million of the Ambac guaranteed senior notes. Following a contested hearing judgment was delivered by Mr Justice Barniville rejecting the objections of ESM and sanctioning the Scheme.

GROUNDS OF OBJECTION

In his judgment Mr Justice Barniville noted that the objection by ESM had been "refined somewhat at various stages" but ultimately boiled down to assertions that:

1. the financial position of Ambac was not as negative as presented in the scheme circular and therefore the necessity for the commutation of its guarantee obligations as part of the Scheme was undermined;
2. the Court did not have jurisdiction to sanction a scheme that provides for the release of claims against a third party (specifically Ambac in this case) particularly where ESM asserted that such claims have constitutional protection as property rights under Article 40.3 and Article 43 of the Constitution of Ireland and further that the scheme circular did not demonstrate that the releases were necessary for the success of the Scheme; and
3. the Scheme ought to have been proposed and put forward in New York rather than Ireland.

JUDGMENT APPROVING THE SCHEME

Barniville J. followed a number of longstanding Irish and international precedents on the tests and principles applicable to the approval of schemes of arrangement. In particular the Court applied the leading Irish decision of Mr Justice Kelly in *Re Colonia Insurance* (*Ireland*) Ltd [2005] 1 IR 497 ("*Colonia*") in which Kelly J. had endorsed and adopted a number of Irish and English authorities and set out the following five criteria required to be satisfied in order to sanction a scheme being that:

1. sufficient steps have been taken to identify and notify all interested parties;
2. the statutory requirements and all directions of the court have been complied with;
3. the classes of creditors are properly constituted;
4. no issue of coercion must arise; and
5. the scheme of arrangement is such that an intelligent and honest man, a member of the class concerned, acting in respect of his interest might reasonably approve it.

In terms of those five criteria, the Court held that the first three criteria were not in issue at all. In the case of the fourth criterion, namely, the question of coercion, Barniville J. noted that:

"such coercion must involve improper coercion or pressure ..... All schemes involve an element of coercion, in the sense of a dissenting member being rendered bound by the scheme, notwith- standing its disagreement with the scheme, and it seems to me that that is not the sort of coercion that Mr Justice Kelly was referring in the fourth criteria which he identified which the Court had to be satisfied with before it could sanction a scheme. In any event, it is not suggested in the present case that there was any such improper coercion in the case of ESM."

The Court found that the real issue in this case concerned the fifth criterion and whether the Scheme was such that an intelligent and honest person, being a member of the relevant class concerned, acting in respect of his or her interest might reasonably approve. In considering this criterion Barniville J. found the judgment of Mr Justice Parker in Re Ocean Rig UDW Inc (18 September 2017, Grand Court of the Cayman Islands, Parker J) to be of "*considerable assistance*".

Barniville J. quoted and firmly endorsed several passages from the decision in Ocean Rig regarding the application of the fifth criterion and stated that:

"the court should be slow to differ from the vote at the relevant meeting. However, the court must be satisfied that the proposed Scheme is reasonable, viewed from the perspective of an honest, intelligent and experienced person of business who is familiar with the Scheme. The court should only differ from the majority if it is satisfied that an honest, intelligent and reasonable member of the class could not have voted for the Scheme. The onus is on the objecting creditor, in this case ESM, to establish this and it must do so, in my view, to the standard of the balance of probabilities."

The Court was of the view that Mr Justice Parker's concluding remarks in Ocean Rig had "particular resonance" in this case where Mr Justice Parker had stated that the tests to sanction a scheme of arrangement should not be applied in order to enable minority creditors to "hold to ransom" the majority to prevent a scheme or force a modification to a scheme.

Mr Justice Barniville also considered two English cases Re Telewest [2004] EWHC 1466 (Ch); [2005] BCC 36 and Re British Aviation Insurance Co. Ltd [2005] EWHC 1621 (Ch) and in concluding his analysis of the law in this area noted that it is extremely rare for a court to refuse to sanction a Scheme where it has been approved by an overwhelming majority and by the required special majority where the classes are correctly constituted and where there is no suggestion that the majority did not represent the views of the class.

GROUNDS FOR OBJECTION

Having outlined the applicable tests and authorities Mr Justice Barniville went on to consider and reject each of the objections put forward by ESM.

1. Alleged Material Deficiencies

ESM's first ground of objection was that the scheme circular was materially deficient, particularly with respect to the financial position of Ambac. Whilst Barniville J. accepted that the financial position of Ambac was clearly of significance to the Scheme he was not satisfied that there was any material deficiency in the information provided in the scheme circular in relation to the financial position of Ambac or otherwise and concluded that Ambac was clearly in a difficult or distressed financial position.

2. Third Party Releases

The second ground of objection was that the applicable legislation could not be interpreted so as to enable third party releases to be provided for in a scheme and that the court had no jurisdiction to sanction a scheme of arrangement providing for the release of claims. ESM argued that strict construction should be given to the relevant statutory provision insofar as it could interfere with an Irish constitutional right.

The Court considered a number of authorities from Australia and England (including *Re Opes Prime Stockbroking Ltd* [2009] FCA 813 and *Re Lehman Brothers International (Europe) (in administration)* (No. 1) [2010] 1 BCLC 496 respectively) noting that legislation in those jurisdictions was *"similar, if not identical"* to the applicable Irish legislation. The Court noted that third party releases are *"fairly common"* in schemes of arrangements that have come before the courts of other jurisdictions.

Barniville J. concluded that the determinations in those cases (i.e. that an arrangement between a company and its creditors does not necessarily exclude the inclusion of releases of claims against third parties by those creditors where there is a sufficient nexus between the scheme and the released claims) reflected "the correct and proper interpretation of the relevant provisions of Part 9 of the 2014 Act" and that he was satisfied to "adopt the pro-release interpretation of Mr Justice Finkelstein in the Opes Prime case". He accepted that the third party releases were necessary under the Scheme to amongst other things give effect to the commutation of the Ambac guarantee and bring finality to the affairs of Ballantyne so that it may ultimately be wound up.

As to the constitutional point the Court (whilst not determining whether ESM as a non-Irish body corporate had the benefit of Irish constitutional rights) concluded that the involvement of the court in deciding whether to sanction a scheme of arrangement provides for the appropriate protection and balance of any constitutional rights involved and that a court will not sanction a scheme unless satisfied that it is fair and meets the relevant tests.

3. New York Dimension

Mr Justice Barniville noted that it was not entirely clear what objection was being maintained under this heading as it had *"morphed and changed in the course of affidavits, the written submissions and the oral submissions"*.

He rejected any contention that the restructuring should have been pursued before the US courts and did not accept that the fiduciary duties applicable to Ballantyne and its directors were governed by New York law. He also accepted Ballantyne's submissions that an Irish scheme could be utilised to restructure New York law governed debt and in doing so recognised the decisions in *Re Magyar Telecoms BV* [2015] 1 BCLC 418; Re Noble Group Ltd [2018] All ER (D) 100; *Re Codere Finance (UK) Ltd* [2015] EWHC 3778 (Ch) and *Re Zlomerex International Financial SA* [2015] 1 BCLC 36.

Finally, he concluded that ESM had not demonstrated any good reason for him not to sanction the Scheme based on the existence of a recently issued federal complaint against Ambac by ESM that ESM asserted would have been compromised by the Scheme (in particular the third party release).

SCHEME PROCESS TIMETABLE

- Court papers filed for application to convene the scheme meetings - 24 April 2019
- Hearing before the Commercial Court and order made to convene scheme meetings (Judge Barniville) - 29 April 2019
- Scheme meetings held - 22 May 2019
- Directions hearing prior to hearing to sanction the scheme (Judge Haughton) - 23 May 2019
- Contested hearing to sanction the Scheme (Judge Barniville) - 5 June 2019.
- Detailed judgment approving the Scheme (Judge Barniville) - 6 June 2019
- Chapter 15 hearing (Judge Garrity) - 11 June 2019
- Scheme implemented in full - 17 June 2019

DECISION

Mr Justice Barniville ultimately made an order sanctioning the Scheme on the basis that:

1. the pre-conditions set out in Section 453 of the 2014 Act were satisfied;
2. the criterion set out in Colonia, that there was no coercion of the minority at the relevant scheme meetings, was met; and
3. an honest and intelligent person acting reasonably in his or her own interest would have supported the Scheme.

CHAPTER 15

Following the making of the Irish order an application was made to the US Bankruptcy Court to recognise the Scheme as a "foreign main proceedings" under Chapter 15 of the US Bankruptcy Code in circumstances where the Scheme restructured New York law governed debt and where Ballantyne's principal assets were located in the United States. Whilst that application was initially contested by ESM that objection was not pursued at the hearing and an order was made on 11 June 2019 recognising the Scheme.

KEY POINTS

This case demonstrates the effectiveness of an Irish law scheme of arrangement (which has been on the statute books for over 50 years) as a tool to implement complex international debt restructurings. Together with the extensive use of the examinership process to restructure insolvent Irish businesses it highlights the effectiveness and robustness of Ireland as a jurisdiction in which to pursue such restructurings.

The Irish legislation on schemes of arrangement is broadly similar to the relevant legislation in England, Australia and several other jurisdictions. The judgment of Mr Justice Barniville underlines the persuasiveness of English and international jurisprudence in this area and the willingness of the Irish courts to consider the well-developed jurisprudence of those jurisdictions in evaluating and ultimately sanctioning a scheme of arrangement.

CONTACT US

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