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Scheme of Arrangement: An English Law Cram Down Procedure

Introduction

A scheme of arrangement is a formal statutory procedure under Part 26 of the Companies Act 2006 under which a company may enter into a compromise or arrangement with its members or creditors (or any class of them). There is no need for a company to be insolvent under English law for a scheme of arrangement to be available to it. The scheme of arrangement may, however, be used in conjunction with a formal insolvency procedure.

Schemes of arrangement are flexible: the legislation does not prescribe their terms. Creditor approval and court sanction are necessary, however.

The process

The process of structuring and implementing an English scheme of arrangement requires the parties to a scheme of arrangement to go through the following stages:

- The company proposing the scheme of arrangement must seek a court order convening creditor and/or member meetings (as relevant) in order to vote on the proposed scheme;
- The company must provide all parties required to attend the meeting(s) a statement setting out key aspects of the proposed scheme of arrangement;
- A meeting or meetings are convened at which the attendees are separated into classes and will be required to vote on the proposed scheme of arrangement. At least 50% in number constituting 75% in value of each relevant class of creditors must vote in favour of the scheme of arrangement for it to proceed to sanction;
- A class must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult with a view to their common interest. Determining how classes are to be split is often a delicate balancing exercise;
- Once the scheme of arrangement has been approved by the requisite majority of each class, the company will apply to the English court and request that it sanction the scheme of arrangement;
- The scheme of arrangement will become effective upon delivery of the relevant sanction order by the English court to the Registrar of Companies in England & Wales and will bind all creditors of each relevant class.

Timing

The issue of timing is, for obvious reasons, connected to the complexity of the proposed scheme of arrangement. As long as the scheme of arrangement progresses in an uncomplicated fashion, the process could be completed within six to eight weeks of the company making its first application to the English courts. Negotiations involving the commercial terms of the scheme itself lengthen the timetable.

Key characteristics

Some of the key features of a scheme of arrangement are as follows:

- As long as the requisite voting thresholds are obtained, claims of secured creditors can be compromised or written off without their unanimous consent. This distinguishes a scheme of arrangement from a company voluntary arrangement which does not bind secured creditors;
- The statutory voting thresholds override thresholds in agreements e.g. requirements for unanimous consent to alter terms;
- Unlike a formal insolvency procedure, a scheme of arrangement will not in and of itself trigger a moratorium. In other words, it will not give rise to a stay on creditor enforcement action and legal proceedings against the company, although this can be provided for if and when it comes into effect;

- One of the advantages of a scheme of arrangement is its flexibility. A scheme of arrangement can be used as a mechanism to provide a broad range of restructuring solutions including debt for equity swaps, new money, re-setting of payment terms and the release of security or guarantees.

Jurisdictional hurdle – English law schemes of arrangement and foreign companies

English law schemes of arrangement are frequently used in complex financial restructurings and have become a favoured instrument for foreign companies, often providing a more efficient and responsive alternative to local restructuring tools.

In order for the English court to sanction a scheme of arrangement involving a foreign company, the court needs to be satisfied that there is a "sufficient connection" between the foreign company and England for it to have jurisdiction to sanction the relevant scheme. Recent cases[1] have illustrated the English courts' willingness to exercise its jurisdiction to sanction schemes of arrangement proposed by foreign companies with a relatively limited connection to England.

The English courts have taken into account a broad range of factors in deciding whether the foreign company has a "sufficient connection" to England, including:

- Whether the foreign company has assets in England;
- Whether the foreign company carries on activities in England;
- The location of restructuring negotiations;
- The jurisdiction and choice of law provisions in agreements to which the company is a party; and
- The presence of creditors within the jurisdiction or their submission to the jurisdiction.

1 Examples of recent cases include: In the matter of Rodenstock GmbH [2011] EWHC 1104 (Ch), In the matter of Tele Columbus GmbH [2010] and Re La Seda De Barcelona SA [2010] EWHC 1364 (Ch).

Rodenstock

In the recent *Rodenstock GmbH* case the English court concluded that a scheme of arrangement in relation to a German incorporated entity ought to be sanctioned. Significantly, the English court was satisfied that the only connection to England required in this case to enable the court to satisfy itself as to the "sufficient connection" test and exercise its jurisdiction to sanction the scheme of arrangement was the choice of English law and exclusive jurisdiction clause contained within a Senior Facilities Agreement.

Primacom

Primacom Holding GmbH and others v Credit Agricole and others [2012] EWHC 164 (Ch) involved a German company wishing to propose a scheme of arrangement, where none of its creditors were domiciled in England & Wales. Nevertheless, the High Court sanctioned the scheme of arrangement and held that the company had a sufficient connection to England & Wales because the intercreditor agreement and all finance documents were governed by the law of England & Wales and the parties had submitted to the English courts' jurisdiction. The High Court concluded that Council Regulation (EC) 44/2001 (an EC Regulation requiring matters applying to solvent companies to be heard in the jurisdiction of the company's domicile) did not prevent the English court from having jurisdiction, on the grounds that the German company was effectively insolvent, since the scheme was an alternative to German insolvency proceedings.

Enforceability of schemes outside England

While there remains an unresolved dispute before the German Courts[2] (in relation to a local insurance policyholder with a German law insurance policy) the general consensus seems to be that an effective English scheme of arrangement will bind secured lenders who have agreed in the transactional documents that the English courts would have exclusive jurisdiction and that their claims would be governed by English law. This would either be on the basis of private international law, or under common law, as a matter of comity.

2 OLG Celle 8 U 46/09 (in relation to the Equitable Life Scheme)

Comment

The fully reasoned judgment in Rodenstock is important in that, in appropriate circumstances, companies incorporated outside of England may be able to avail themselves of the cram down mechanism under a scheme of arrangement. This will be particularly attractive where the local law does not have a mechanism like a scheme of arrangement available to effect a restructuring.

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