

PART I

INTRODUCTION

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INTRODUCTION AND OUTLINE OF PROCESS

A scheme of arrangement, or simply a ‘scheme’, is a statutory procedure which allows a company to reach an arrangement or compromise with its members or creditors (or any class of them). **1.01**

The court has summarised the purpose of schemes as follows:¹ **1.02**

It has been the legislative policy for well over a century to encourage compromises and arrangements between a company and its creditors or members. That has been achieved by the enactment of a statutory mechanism to enable the absence of consent of minority creditors or members to be overcome, provided that a sufficient number of the relevant creditors or members agree with the proposed compromise or arrangement and the court gives its approval. If that occurs, then the dissentient minority will be bound by that compromise or arrangement. That of course in the case of a creditor is an encroachment on his right to be paid what he is owed in accordance with the contractual terms. But the utility of the statutory mechanism is particularly obvious in a case where a company is in financial difficulties but can persuade most, but not all, of the relevant creditors that the company’s debts should be restructured rather than that those creditors should exercise their rights, including the right to put the company into liquidation.

The procedure is currently provided for under Part 26 of the Companies Act 2006, and there is nothing in the legislation that prescribes the subject matter of a scheme. Specifically, a scheme can be used to effect a ‘compromise or arrangement’ between a company and: (i) its creditors or any class or them; or (ii) its members or any class or them.² **1.03**

If it is approved by the requisite majorities of (each class of) such members or creditors, sanctioned by the court and the order of the court sanctioning it is delivered to the Registrar of Companies, the scheme will be binding on all of the company’s members or creditors in the relevant class(es), on the company itself or, in the case of a company in the course of being wound up, on the liquidator and contributories of the company.³ **1.04**

¹ *Garuda Sea Assets Ltd v Perusahaan Perseroan (Persero) PT Perusahaan Penerbangan Garuda Indonesia* [2001] EWCA Civ 1696 at para 2.

² Companies Act 2006, s 895(1).

³ Companies Act 2006, s 899(3).

Uses

- 1.05** Within certain limits, a scheme could be a compromise or arrangement about anything which the company and its creditors or members may agree amongst themselves.⁴
- 1.06** With respect to creditor schemes, as a rule of thumb, a scheme can achieve anything that a company and its creditors could achieve contractually or under statute. Examples of the transactions that can be implemented by way of a creditor scheme include (but are not limited to):
- (i) a release or compromise of secured and unsecured debts or a change in their ranking;
 - (ii) a share issue;
 - (iii) a debt-to-equity exchange, combining (i) and (ii) above;
 - (iv) the introduction of a debt tranche which is senior or junior to the claims of the scheme creditors;
 - (v) a moratorium;
 - (vi) the transfer of assets from the debtor to a new company or consolidation of assets when combined with a sale and purchase agreement between the debtor and the new company;
 - (vii) the transfer of claims from or among scheme creditors;
 - (viii) amendments to agreements or the entry into of new agreements;
 - (ix) the release of rights of action against third parties which are designed to recover the same loss; or
 - (x) the determination of methods for agreeing claims, and settling disputes.⁵
- 1.07** Similarly, a member scheme may be used to implement a variety of transactions, including any one or more of the following in respect of a company incorporated in the United Kingdom:
- (i) a takeover of that company;
 - (ii) a demerger of, or from, that company;
 - (iii) the addition of a new holding company above that company (often used to effect a corporate redomiciliation of the group or to help facilitate the ability to make a capital reduction);
 - (iv) a return of capital to shareholders of that company;
 - (v) the removal of minority shareholders of that company; or
 - (vi) group reorganisations combining one or more elements of (ii) to (v).⁶

Prevalence

- 1.08** Although a scheme of arrangement under Part 26 of the Companies Act 2006 is not an insolvency procedure as such, during and following the 2008 'credit crunch', creditor

⁴ Chapters 2, 3 and 5 in particular contain detailed descriptions of the limits that apply to schemes in general.

⁵ Chapters 6, 7 and 8 contain a detailed discussion of issues specific to creditor schemes.

⁶ Chapters 9 and 10 contain a detailed discussion of issues relating to member schemes.

schemes have proven to be an important debt restructuring and insolvency tool. For example, at the start of the 'credit crunch', the restructurings of *IMO*,⁷ *British Vita*,⁸ *Countrywide*⁹ and *McCarthy & Stone*¹⁰ were all implemented, in part, pursuant to schemes. More recently, the *La Seda*,¹¹ *Cattles*,¹² *Metrovacesa*,¹³ *Rodenstock*¹⁴ and *PrimaCom*¹⁵ restructurings have all involved schemes of arrangement, to name but a few.

Member schemes have always been a popular method to effect internal group reorganisations, and in more recent times have become the structure of choice (at least with respect to higher value transactions) for implementing a recommended takeover of a public company that is both incorporated and traded in the United Kingdom.¹⁶ **1.09**

For example, in 2001, only one takeover by scheme of arrangement of a public company incorporated and traded in the United Kingdom was announced.¹⁷ By contrast, in 2011 there were 16 firm offer announcements for public companies incorporated in the United Kingdom or the Channel Islands and traded on the Main Market operated by London Stock Exchange plc where the consideration offered was £100 million or more, and ten of these were structured as schemes of arrangement. Similarly, in the first six months of 2012 there were 14 firm offer announcements for companies in this category and ten of these were structured as schemes of arrangement. **1.10**

Process

Once the company proposing the scheme has determined its terms (which can be a lengthy and complex process especially for creditor schemes and some group reorganisations) and the accompanying documentation has been drafted, the next step is obtaining approval of the scheme. This is a three-stage process which is described in detail in Chapter 4, and is summarised below: **1.11**

- (i) an application to the court for permission to convene the relevant meeting(s) of creditors or members (or the relevant class(es) of them);
- (ii) approval by the required majorities of members or creditors (or the relevant class(es) of them) at those meetings; and
- (iii) an application to the court for an order sanctioning the scheme and, if granted, delivering the order to the Registrar of Companies.

Each of the three stages in the process serves a distinct purpose. At the first stage, the court is concerned to ensure that those who have the right to vote on the proposed arrangement **1.12**

⁷ *Re Bluebrook Ltd* [2009] EWHC 2114 (Ch).

⁸ Unreported.

⁹ Unreported, Norris J, 23 March 2009.

¹⁰ *Re McCarthy & Stone* [2009] EWHC 712 (Ch).

¹¹ *Re La Seda de Barcelona S.A.* [2010] EWHC 1364 (Ch).

¹² [2010] EWHC 3611 (Ch).

¹³ *Re Metrovacesa SA* Unreported 29 March 2011, Vos J.

¹⁴ [2011] EWHC 1104 (Ch).

¹⁵ [2011] EWHC 3746 (Ch).

¹⁶ Chapter 10 contains a detailed discussion of member schemes used to implement a takeover.

¹⁷ The merger of HL Income & Growth Trust plc and Aberdeen High Income Trust plc, announced in July 2001.

will have a proper opportunity to participate and vote (in person or by proxy) at the meeting or meetings at which the proposals are to be considered and voted upon. The second stage ensures that the proposals are approved by the required statutory majorities of the relevant class(es) of creditors or members. In the third stage the court will consider whether to exercise its discretion to sanction the scheme, taking into account factors such as whether: (i) the required procedural requirements have been followed; (ii) the classes of members or creditors were fairly represented, and that the majority acted bona fide and that there was no oppression of minorities; (iii) having been approved at the scheme meeting(s), the terms of the scheme are fair 'such that an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve [it]'; and (iv) there is any 'blot' on the scheme or any reason that the court ought not exercise its unfettered discretion to sanction the scheme.¹⁸

Limitations

1.13 It is important to note that schemes do, however, have their limitations, particularly when compared with composition proceedings in other jurisdictions such as the US (Chapter 11) and Ireland (examinership) in a restructuring context. Though a discussion for another day, the authors believe that the recent downturn has exposed some significant weaknesses in the scheme regime and that the legislature should consider amending Part 26 of the Companies Act 2006 as it applies to creditor schemes (or introducing a new procedure) to:

- (i) allow compositions or arrangements to be passed with the consent only of a senior class of creditors whose claims are impaired, even if junior classes of creditors or shareholders vote against it—this is referred to as cross-class cram-down and is a feature of Chapter 11 and the recent Irish examinership law;
- (ii) delete the numerosity test for approval of the scheme—the majority in number requirement in section 899(1) of the Companies Act 2006—to bring it into line with the company voluntary arrangement regime (this point might also apply to member schemes);
- (iii) provide for a moratorium for large companies (the small company moratorium is discussed below but its criteria are set at such low levels as to make it rarely applicable in practice);
- (iv) provide for the restructuring of a group of companies to be taken together;
- (v) allow schemes to change the rights of shareholders without their consent if, under the relevant comparator, those shareholders would receive nothing;
- (vi) prohibit the termination of contracts upon entering into a scheme or insolvency procedure;
- (vii) allow for the 'cram-up' of, for example, creditors whose claims for principal and interest are unimpaired but who have contractual rights against the debtor which would prevent the implementation of the scheme; and
- (viii) facilitate debtor in possession financing.

¹⁸ *Re TDG plc* [2009] 1 BCLC 445 at pp.450–1; *Re National Bank Ltd* [1966] 1 WLR 819; *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co Ltd* [1891] 1 Ch 213, 239; and *Re Anglo-Continental Supply Co Ltd* [1922] 2 Ch 723, 736.