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Insolvency & Restructuring - Germany

Court refuses to recognise an English scheme of arrangement

Contributed by **Clifford Chance LLP**

August 03 2012

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Introduction

On February 15 2012 the German Federal Court of Justice refused to recognise an English scheme of arrangement in relation to the German branch of the insurance company Equitable Life, finding that recognition of the scheme would be contrary to Articles 8, 12(1) and 35 of EU Regulation 44/2001 on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters. The scheme of arrangement was intended to be used by Equitable Life in order to restructure its contractual portfolio, including German-law governed contracts with German consumers.

English (solvent) schemes of arrangement have gained considerable attention for restructuring non-English companies. *TeleColumbus*, *Rodenstock* and *Primacom* are the three reported cases in which German-based companies with their centre of main interests in Germany successfully used a scheme as an alternative to local restructuring/insolvency options.

A scheme is a statutory contract or arrangement between a company and its creditors (or any class of them) made pursuant to the English Companies Act 2006. It is not an insolvency proceeding, but can be implemented in conjunction with formal insolvency proceedings (eg, administration or liquidation) or on a standalone basis. This makes schemes an attractive and value-preserving option when compared to German insolvency proceedings. Moreover, schemes are of particular interest in cases where financial restructurings require the unanimous consent of all financing parties affected. Since such consent can often be difficult to obtain, the interests of the distressed company and the consenting creditors can potentially be adversely affected by a minority of non-consenting lenders, whose typical strategy in such a situation is to leverage their position in order to obtain a better deal in return for their consent. As a scheme of arrangement requires approval by only a majority in number representing three-quarters in value of the creditors (or any class thereof) – present and voting in person or by proxy at the creditors' meeting(s), it represents a useful mechanism for:

- overcoming the impossibility or impracticality of obtaining the individual consent of every creditor; and
- preventing a minority of creditors – where appropriate – from frustrating the interests of the company's creditors generally.

Against this background, the refusal of the Federal Court of Justice to recognise the scheme in *Equitable Life* is of specific interest, since schemes of arrangement can be effectively used to implement financial restructurings for German companies only if they are also recognised in Germany.

UK courts recognise jurisdiction to sanction English schemes for German companies

Recent cases such as *TeleColumbus*, *Rodenstock* and *Primacom* have shown that English courts generally do accept jurisdiction to sanction schemes of arrangement pursuant to Part 26 of the UK Companies Act 2006 in relation to German companies, if:

- the relevant German company is considered a 'company' within the meaning of Section 895 of the Companies Act 2006; and
- there is a sufficiently close connection between the persons and subject matters of the relevant dispute and the English jurisdiction to make it appropriate for that

jurisdiction to be exercised.

In addition, the English courts consider whether the proposed scheme is fair and equitable for the creditors involved.

In *re Rodenstock GmbH*(1) the judge took the view that the definition of 'company' extends to a company liable to be wound up under the English Insolvency Act 1986, and there is no reason why a German company should not be such a company. In addition, the judge found that there was a sufficient connection to the English jurisdiction, given that English law was the governing law for all the creditor arrangements that were proposed to be affected by the scheme.

In *re Primacom GmbH*,(2) the judge considered, among other things, whether the English courts have jurisdiction to sanction a scheme where a majority of the scheme creditors are domiciled outside the United Kingdom. The judge held that it is not a prerequisite for jurisdiction that the majority of the scheme creditors be domiciled in England, if a sufficient connection to England can be established.

At present, English courts sanction schemes for non-English companies only if they are satisfied that the scheme will be enforceable in the jurisdiction of the registered office or centre of main interests of the company applying for the scheme. The judges form their view on the basis of expert evidence presented to the court.

Federal Court of Justice ruling

In *Equitable Life* the Federal Court of Justice considered several questions which are relevant for the recognition of schemes of arrangement in Germany.

First, the court concluded that schemes are not capable of recognition under the German Insolvency Code and the EU Insolvency Regulation. Schemes are not comparable to insolvency proceedings, which aim at the partial satisfaction of all creditors of the relevant company, but have much in common with settlement arrangements among a specific group of creditors.

Second, the court considered whether schemes should be recognised as 'judgments' within the meaning of EU Regulation 44/2001. The court has held that schemes do qualify as adversarial proceedings and are therefore similar to judgments within the meaning of the regulation. While the court expressed its sympathy with this view, it abstained from making a final decision on this point because specific insurance regulation had to be applied. A positive decision on this question would have brought the long-awaited breakthrough for the future treatment of schemes under German private law.

Finally, the court confirmed that the scheme sanctioned for *Equitable Life* would be contrary to Articles 8, 12(1) and 35 of EU Regulation 44/2001, which provide specific regulation on jurisdiction in insurance-related matters. According to Article 12(1), an insurance company may initiate legal court proceedings only against its creditors before the courts of the EU member state in which the relevant creditor is situated.

Comment

Although the Federal Court did not recognise the scheme of arrangement in *Equitable Life*, this insurance-related decision appears to be of limited relevance for future schemes in relation to the successful financial restructuring of German companies outside the scope of insurance companies.

The ruling does not contradict the existing judgments of the English courts, but rather gives a positive forecast. The fact that the court based its judgment on specific insurance-related provisions of the Judgment Regulation can be seen as a positive indication that outside the scope of these specific provisions, schemes will be recognised in Germany as judgments. It remains to be seen whether *Equitable Life* can be construed as the first step towards a general recognition of schemes outside insurance-related cases.

For further information on this topic please contact Stefan Sax or Cristina Weidner at Clifford Chance LLP by telephone (+49 69 7199 01), fax (+ 49 69 7199 4000) or email (stefan.sax@cliffordchance.com or cristina.weidner@cliffordchance.com).

Endnotes

(1) [2011] EWHC 1104 (Ch).

(2) [2011] EWHC 164 (Ch).

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