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# International restructuring – have schemes of arrangement come of age?

## With businesses operating in a global market and barriers to capital movement falling, restructuring has increasingly become a cross-border affair. Journalist John Rolinson hears from Clifford Chance experts about the impact of English schemes of arrangement on international restructurings.

Cross-border restructurings create challenges for all stakeholders, be they private equity sponsors, senior lenders, mezzanine or unsecured lenders. Everyone is jostling for position and wanting to know how they are going to be treated.

Developments in cross-border insolvency law such as the European Insolvency Regulation (EUIR) and the adoption of the UNCITRAL Model Law on Cross-Border Insolvency in the USA, Australia and elsewhere have not helped in restructurings because, as the description of such laws suggests, they deal with companies that are actually insolvent. "Practitioners in England have been trying to find a way of restructuring international groups pre-insolvency," says Philip Hertz, a partner in Clifford Chance's Restructuring Group within the Finance and Capital Markets practice in London. "They've dipped into the toolbox and pulled out the scheme of arrangement, a very helpful procedure because it's a process that can be used for restructuring outside of an insolvency and in many jurisdictions there's nothing similar."

Schemes of arrangement first appeared in the 1800s and were invented to deal with the Indian bank crisis. They keep bouncing back. In the late 1990s, they were used to deal with insurance restructurings.

"The key thing to remember is that while it can be used by English liquidators and administrators, the scheme of arrangement is not an insolvency procedure," says John MacLennan, a partner in Clifford Chance's Restructuring Group within the Finance and Capital Markets practice in London. "You won't find any reference to it in the Insolvency Act: it's rooted in the English Companies Act 2006."

The scheme provides a statutory contract or arrangement between a company and its creditors (or classes of its creditors). It can be proposed by either the company on a stand-alone basis or, if the company goes into liquidation or administration, by the liquidator or administrator. Creditors can also propose a scheme of arrangement but, in a restructuring context, that is very rare.

### English law

It is for the company to identify the

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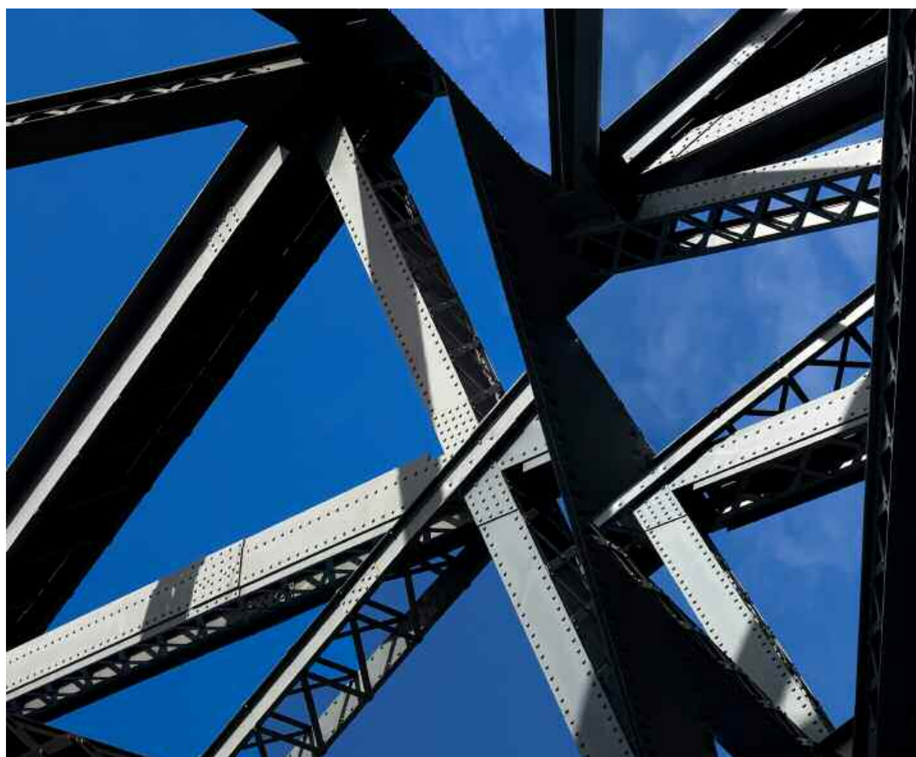

creditors (and any classes of creditors) who will be bound into the scheme.

The scheme needs to be approved by a meeting of creditors (or classes of creditors); to do so, it must meet two thresholds. First is the need for at least three-quarters by value of those creditors at the meeting to vote in favour and second is the need for a majority in number of those creditors voting at the meeting – often referred to as the numerosity test.

Once approved by the creditors, for the scheme to become effective, the scheme must be sanctioned by the Court at a hearing held for the purpose and the court order delivered to the Companies Registry in the UK.

Assuming the scheme becomes effective, what are the ramifications?

"It binds all of the creditors that the company has chosen to be subject to the scheme," says John. "And that's regardless of whether or not they were notified about the scheme, although the company must try and notify all relevant creditors, and whether or not they voted for or against it – or indeed whether they voted at all. The scheme of arrangement is a powerful tool for imposing agreement through a statutory contract despite not all the creditors having approved it."

## Numerosity issue

The numerosity issue means that careful attention needs to be paid to the number of creditors involved. If a large proportion of the debt is held by relatively few creditors, for example, by financial lenders, and the small balance of the debt is held very widely, for example, by trade creditors, the 75% value threshold could be easily passed while a majority of creditors (holding little debt) could easily vote the scheme down.

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In most debt restructurings and almost certainly in all where the level of lenders' debt is reduced in some way, every lender will be required to consent. The scheme of arrangement avoids the need for unanimity, allowing the will of the majority to prevail.

"The ability to cram down the minority of creditors who do not agree to the restructuring outside of insolvency proceedings is a particularly powerful aspect," said John. "In English law, we take this for granted with schemes of arrangement but it is certainly not the case in many other jurisdictions."

So how does this help in an international context?

Philip says the received wisdom a couple of years ago was that if you wanted to subject an overseas company to an English procedure, you had to shift its centre of main interest (COMI) into the UK. COMI is a concept recognised under the EUIR and the UNCITRAL Model Law. In broad terms, if a company's creditors recognise that the company has headquartered in a particular jurisdiction, the insolvency laws of that jurisdiction will be applicable to creditors on its insolvency and will inform the restructuring process.

## Moving the COMI

But where the COMI is outside the UK, actually moving it to the UK may well involve physically moving the headquarters and employees and effectively require sign-off from the main creditors. That's not such a difficult issue with holding companies – it was done with Schefenacker, a German company that supplied components to the automobile industry. However, when you are dealing with operating companies with many trade creditors and operations overseas, moving the COMI, if this is possible, is likely to be difficult and expensive. And, as seen on one recent case, it is not certain that such a move would go unchallenged.

"A lot of people still feel that subjecting a non-English company to any sort of English procedure requires moving the COMI," said Philip. "That is not the case and that is the big difference with schemes of arrangement."

A foreign company can be subjected to a scheme even if the COMI is not moved to the UK provided that the English Court has jurisdiction to wind up that company. The English Court does have such jurisdiction although before exercising its discretion to wind up such company it will need to be satisfied that it has sufficient connection with England.

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Avoiding a COMI shift saves time and money. Sufficient connection can be shown by management being present in the jurisdiction or by having assets there. Recent restructurings where Clifford Chance has taken a leading role such as SSP, Tele Columbus, Metrovacesa and Rodenstock, have pushed the envelope further as to what sufficient connection really means. Although these cases have been unopposed, in each case that connection was found by dint of the fact that there were English law governed debt documents, the companies having no other connection of significance with the UK.

Despite the belief of some people, case law shows that the EUIR does not muddy the water so as to require that the foreign company has its COMI or an establishment in the UK in order for the English Court to have jurisdiction to wind up the company.

## Fair deal

Before exercising its discretion to sanction a scheme, the Court will consider whether it is fair. Two key elements will be whether it is fair commercially and whether the scheme will be binding on the creditors it purports to bind. So far as commercial fairness is concerned, the Court will view the creditors as the people best placed to judge; if the requisite majority of the creditors approve it then the Court will be loathe to second guess their commercial assessment.

The Court will also want to be assured that the effect of the scheme and the restructuring will be recognised in the jurisdiction in which the company is based. This is also a part of fairness because, if a creditor can 'get around' the scheme by bringing its claim for its pre-restructured debt in that jurisdiction because the scheme is not recognised, this will be unfair to those creditors who are subject to the jurisdiction of the English Court and who could not pursue such claims in that other jurisdiction. Moreover, from a practical and commercial perspective it is in no one's interest if some creditors can 'each run' the scheme in this way.

Stefan Sax, a partner in Clifford Chance's Restructuring and Insolvency Group in Frankfurt, says that, "from our experience, many overseas jurisdictions will recognise English schemes and their effects. That recognition typically flows from the rules of private international law which will be applicable. Since an English scheme is an appropriate and valid means of amending an English law-governed contract, it follows that the scheme should be recognised in that overseas jurisdiction as being capable of amending the English law governed debt elements at the heart of the restructuring."

Issues of public policy in the relevant jurisdiction may prevent recognition on this or some other basis. Depending on the individual jurisdiction involved, public policy aspects may vary. A further and related point concerns the availability of an equivalent local proceeding. If a proceeding is available, then an English Court may take the view that it, rather than for an English law scheme, should be used.

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From a practical perspective, it is important that an expert – an academic or a practitioner – provides evidence for the benefit of the English Court on the questions of recognition and the availability of comparable procedures.

## Active cooperation

Schemes of arrangement are not 'lender-led', notes Stefan. "They will be carried forward and implemented by the company and that requires the active cooperation of the management of the company. They will need to provide all the documents and the supporting witness statement to the English Court."

Stefan also notes that in Germany, and in some other jurisdictions, there needs to be cooperation from shareholders too. If shareholders are not willing to form part of the solution and try to oppose or derail the scheme process, then lenders need to consider strategies for removing the block, such as enforcement of any share collateral, as a first step. The time and cost implications of such actions need to be taken into consideration.

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## Foreign law governed debt

The flexibility of schemes is obvious where a company has no connection with the UK other than English law governed debt to be restructured and there is no similar pre-insolvency process in its jurisdiction. If in these circumstances some of the debt is not governed by English law but by an overseas law, on the face of things you can't use a scheme.

"But you could perhaps amend the governing law clause to English law with majority lender consent," said John. If so, "it would open the door to restructuring what was an overseas law-governed debt via a scheme. This is not something that has been tried and tested so far as we know, but it is something to consider when thinking of using schemes."

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# Clifford Chance contacts

**To discuss any of the issues in this publication, please contact one of our market experts below:**

**Philip Hertz**
Partner, London
T: +44 (0)20 7006 1666
E: philip.hertz@cliffordchance.com

**John MacLennan**
Partner, London
T: +44 (0)20 7006 1642
E: john.maclennan@cliffordchance.com

**Stefan Sax**
Partner, Frankfurt
T: +49 697199 1549
E: stefan.sax@cliffordchance.com

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