SCHEME OF ARRANGEMENT: A VIABLE EUROPEAN RESCUE STRATEGY?

Recently a Spanish company was able to restructure parts of its debts by using an English "scheme of arrangement". Whether such a rescue will be recognized in the laws of the other EU member states is however doubtful.

Scheme of arrangement

A "scheme of arrangement" is an English mechanism, which takes the form of a compromise or arrangement between a company and its members or creditors (or any class of them) under Part 26 of the Companies Act 2006.[1] A scheme of arrangement can be used to effectuate a solvent reorganization of a company or group structure, including by merger or demerger. Furthermore, such a scheme can function with the aim to effect insolvent restructurings such as by a debt for equity swap or by a wide variety of other debt-reduction options. The process to get a scheme sanctioned by the English court commences by an application to the court, to be filed by the company or any creditor, for an order that a meeting of creditors is summoned. According to its applicable rules, a scheme requires approval by at least 75% in value of each class of the members or creditors who vote on the scheme, which will be also at least a majority in number of each class. In case the scheme includes a reduction in the company's share capital, a separate special resolution is required of the company's members (threshold: a 75% majority of those voting). Only with permission of the court a meeting can be convened of members and creditors to vote on the scheme. It will be at this point that the court will review whether any division of the members and creditors into classes for voting purposes is appropriate. If the relevant members and creditors approve the scheme, the court will decide at a further hearing whether to sanction the scheme, and will look at whether the approved scheme is fair. Creditors may challenge the section 899 CA06 scheme at the hearing for leave to convene the scheme meeting or later, during the hearing concerning the sanction of the scheme. Grounds for challenging can include that the meeting is improperly constituted, that the creditors were not given sufficient information or that the scheme is unfair. Generally, though, an English court will be supportive to the restructuring process of an insolvent company, under the assumption that the scheme of arrangement has a reasonable prospect of succeeding in court. For each class of creditors there are separate creditors' meetings. The party proposing the scheme should also determine the correct classes of the creditors, classically based on the test that a class should comprise "those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest." The court will sanction the scheme if it is fair, i.e. a scheme that an intelligent and honest person, a member of the class concerned, and acting in respect of his interest might reasonably approve. If the court sanctions the scheme, the scheme is binding on all affected members, creditors and the company.[2]

Minority creditors' objections

The English High Court, in 2009 *In re McCarthy & Stone Plc.*[3], has provided guidance on how the Courts will view the voting process where there are objections from minority

---

[1] On 6 April 2008, former section 425 of Companies Act 1985 was replaced by section 899 of Companies Act 2006 (CA06).

[2] For an overview, see Vanessa Finch, Corporate Insolvency Law, 2nd. Ed, Cambridge, 2009, 497ff.

[3] [2009] EWCH 1116 (Ch).

creditors. In this case the court approved a scheme of arrangement for a partial debt for equity swap despite the objections of a minority of senior creditors and of the junior creditors. The minority senior creditors objected to the 75% majority decision on the grounds that they were being compelled to release existing valid security in return for new security which, for technical legal reasons, could prove to be invalid in case the company had to enter into insolvency proceedings within the period specified by statute. The High Court confirmed that it will sanction an arrangement although the objections of a minority so long as the votes cast in favour of the arrangement at a creditors' meeting were cast in a way which an honest and intelligent person acting reasonably and rationally would vote. The court therefore took the supportive view that it will endorse a majority decision unless there is something obviously wrong or lacking in relation to the scheme. The junior creditors objected, however, on different grounds, because they submitted that the companies' assets had been undervalued and that the scheme had therefore been approved, based on a false premise. On this point, the court ruled that, as an additional valuation had been obtained and the value had been market tested, there was no reason to suppose that they had been accorded an undervalue. The court considered furthermore that the valuations obtained indicated that there was insufficient value in the assets to see the senior creditors repaid in full, leaving the junior creditors without an economic interest. Until here this short description of a phenomenon on the rise.[4]

La Seda de Barcelona SA

On 26 May 2010, the High Court sanctioned the first ever English scheme of arrangement undertaken by a Spanish company, La Seda de Barcelona SA ("La Seda").5 La Seda is a manufacturer of synthetic packaging and aims to implement the scheme to restructure syndicated debt worth €600 million. This was a part of a wider restructuring, in which La Seda was able to enter into individual restructuring agreements of around €400 million with its bilateral lenders and trade creditors. However, restructuring the syndicated debt in Spain was problematic, as it was confronted with inflexible Spanish law, offering the choice either (i) unanimous agreement from the syndicate, or (ii) commence insolvency proceedings, with the obvious disadvantages such as a long and costly process, with a great chance to end up in bankruptcy liquidation. At the start of negotiations, La Seda obtained agreement to its debt restructuring from 75% by value and 50% by number of the syndicate. This, in principle, opened the door to the English scheme of arrangement. The scheme process is likely to take less time and it avoids the "failure" stigma, as the scheme merely is a Companies Act restructuring process, be it involving two court hearings. In the case of La Seda, a single class meeting was held on 21 May 2010 and over 95% of the lenders who voted at the meeting voted in favour of the scheme.6

International jurisdiction of the English court

[4] See John Tribe, Companies Act Schemes of Arrangement and Rescue: The Lost Cousin of Restructuring Practice?, in: (2009) 24(7) Journal of International Banking & Financial Law, 386; Sandy Purcell and Alex Boyce, The Courts Speak on Valuation in Restructurings: IMO Car Wash, SAS and Wind Hellas Lessons, in: 7 International Corporate Rescue 2010, 129. This trend must have inspired in the Netherlands the recent contribution of J.T. Tol, *Gedwongen medewerking aan een debt for equity swap; een (on)mogelijkheid?*, in: R.J. van Galen et al. (ed.), De Insolvente Vennootschap. Insolad Jaarboek, Kluwer: Deventer, 2010, 1ff.

[5] *Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch).

[6] It should be noted that the case was not so complex as there was only one class of lenders, which were senior secured lenders under the syndicated facility.

An interesting question is, however, whether in such a case the English courts have (international) jurisdiction. Because La Seda is a Spanish company, the English court had to establish its jurisdiction before it could order the meeting of creditors to vote on the scheme. In general, for the court to have jurisdiction to sanction a scheme of arrangement, it must have jurisdiction to wind up the company under the Insolvency Act 1986. Companies registered under the Companies Acts automatically fall into this category. Foreign companies may be wound up compulsorily under section 221 of the Insolvency Act, which deals with unregistered companies. If a company is an unregistered company, it is in the court's discretion to decide. In practice the court will require "a sufficient connection to England and Wales," which does not necessarily have to consist of assets within that jurisdiction.7 In addition, courts have developed two other "core criteria". There must be (i) a reasonable possibility, if a winding-up order is made, of benefit to those applying for the winding-up order (or, in the La Seda case, if the scheme is sanctioned) and (ii) one or more persons interested in the distribution of assets of the company must be persons over whom the court can exercise jurisdiction.8 In La Seda, all the criteria were met, as the senior facilities agreement is governed by English law and is subject to the jurisdiction of the English court and many of the lenders were based in the UK and would therefore benefit from the proceedings. Additionally, La Seda had subsidiaries, a branch office and an employee based in the UK, so there was no doubt that there was a "sufficient connection".
A matter to be discussed is whether the EU Insolvency Regulation (1346/2000/EC) applies. If so, international jurisdiction of the English court is based on whether La Seda had its centre of main interests (COMI) in the EU. If COMI is in Spain, La Seda can only enter into insolvency proceedings in England if it has "establishment" in that member state (Article 3 jo. Article 2(h) of the Insolvency Regulation). Is a requirement to sanction the scheme that La Seda must have its COMI in England or does it suffice that it has an establishment over there? The judge in the La Seda case did follow the general approach of other courts.9 Proudman J, under the heading "Jurisdiction in relation to an overseas company", argued: "First there is the fact that the company is a company established in Spain. At the hearing at which he authorised the scheme meeting Newey J considered the question of jurisdiction under this head. He held that the court had jurisdiction to sanction the scheme. I have seen the submissions made to him which led to that conclusion and I see no reason to revisit it." The heading of the argument seems to indicate that jurisdiction was not based on the Insolvency Regulation. It has been submitted that the view was taken that the Insolvency Regulation was not designed to change the test for whether you can have a scheme of arrangement in England.10 A more obvious explanation, which I support, is that the Insolvency Regulation did not apply, as a scheme of arrangement does not fall within the definition of "collective insolvency proceedings" in Article 1(1) of the Insolvency Regulation and (therefore) is not listed in the Regulation's Annex A.

Recognition of a scheme of arrangement beyond the U.K.

---

[7] *In re Paramount Airways Ltd.* [1992] B.C.L.C. 710.

[8] See *Re Stocznia Gdanska SA v Latreefers Inc (No. 2)* [1998] EWHC 1203 (Comm) applied in the context of schemes in *Re Drax Holdings Limited* [2003] EWHC 2743 (Ch). See Ian F. Fletcher, Insolvency in Private International Law. National and International Approaches, Oxford Private International Law Series, Oxford University Press, 2nd ed. 2005, 3.44ff.; Rebecca Parry, Corporate Rescue, Sweet & Maxwell, 2008, 22-07ff.

[9] *Re DAP Holding N.V and others* [2005] EWHC 2092 (Ch); *Re Sovereign Marine & Gen. Ins. Co. Ltd.* [2006] EWCH (Ch) 1335.

[10] See Ian Wallace, The Growth of Schemes of Arrangement as the Tool of Choice in Complex Restructuring, American Bankruptcy Institute Journal, October 2010, 36ff.

In any pan-european restructuring it must be considered whether the scheme would be recognised by the Spanish court, should any of the Spanish creditors (syndicate lenders) who voted against it attempt to challenge it in Spain. The answer is dependent on Spanish law. Interestingly, the question of recognition of English schemes has recently been decided by German courts. The appeal court in Celle, on 8 September 2009, held that the English scheme of life assurance company Equitable Life and its policy holders was not an insolvency proceeding as defined under the Insolvency Regulation, nor did it qualify as a judgment under the Brussels Regulation (44/2001/EC).11 It also could not be recognized – given the fact that the Regulation does not apply – according the Germany's general rules regarding recognition of foreign insolvency proceedings (Article 343 German Insolvency Act), whilst the judgment – setting aside the sanction of the court – does not consider whether the scheme itself could be recognized as an English law-governed amendment to a contract (the insurance policy).12 A contrary view was however taken by another German court, the Local Court in Rottweil in its decision 17 May 2010.13 The Court considered that on the basis of national insolvency law such a scheme of arrangement is rather similar to the proceedings according to chapter 11 of the US Bankruptcy Code. These proceedings were, in October 2009, qualified by the Federal Court of Justice as "foreign insolvency proceedings" which must be recognized according to Article 343 German Insolvency Act.14 The qualification of a scheme of arrangement as insolvency proceedings nevertheless is rather doubtful, as chapter 11 proceedings aim at the rehabilitation of a company, whilst a scheme itself is rather a corporate law device, which does not have to comprise the totality of the assets of the debtor.15 A scheme also is not a "collective" proceeding, with the aim to liquidate or to reorganize. Another obstacle will be the automatic binding force of the scheme on those creditors who have been against sanctioning the scheme. Where recognition leads to a result which is manifestly incompatible with the major principles of German law, in particular where it is incompatible with basic rights, recognition will not be given, see Article 343(1)(2) German Insolvency Act. The question is whether a partial loss of a claim will indeed infringe an individual's basic rights.16

The conclusion is that the contention (see the Wallace' article) that a scheme of arrangement is the "tool of choice" in complex restructurings is in an European17 context a matter of serious doubt.

[11] OLG Celle 8 September 2009, ZIP 41/2009, 1968. In this case however, the Insolvency Regulation did not apply as the proceedings, according to the court, were excluded under Article 1(2) of the Regulation and the scheme dated of 8 February 2002, whilst the regulation came into force 31 May 2002 (Article 47). In agreement with the result of the Court of Celle's decision that the Brussels I Regulation (44/2001/EC) does not apply: Adrian Walters, Cross-border Insolvency Proceedings in the European Union: The Interface Between the Insolvency Regulation and the Brussels I Regulation, INSOL International Technical Series Issue No. 16, November 2010, 10.

[12] It is understood that the case is to be considered by the German Federal Court of Justice.

[13] LG Rottweil 17 May 2010, ZIP 40/2010, 1964.

[14] BGH 13 October 2009, ZIP 44/2009, 2217; NZI 2009, 859.

[15] In this way Gottwald/Kolmann, *Insolvenzrechts-Handbuch*, 4th ed, 2010, § 133.

[16] For a negative response, see Christian Pilkington, Tom Schorling, Ben davies, UK Schemes Of Arrangement: A Risk of Non-Recognition in Germany?, in: 7 International Corporate Rescue 2010, 239ff. The German Federal Court of Justice 13 October 2009 (footnote 14) does not consider the Chapter 11's "automatic stay" as infringing German's public policy, see Jessica Schmidt, *"Schnellverschluskappe": grundzatsurteil des BGH zur Anerkennung von Verfahren nach Chapter 11 US Bankruptcy Code*, DAJV Newsletter 2/2010, 54ff.

[17] Note that the New York court *In re Castle Holdco 4, Ltd.*, Case No. 09-11761 (REG) (Bankr. S.D.N.Y. 2009) considered the scheme of arrangement to be "foreign main proceedings", which were recognized even prior to the second stage (meeting of creditors). See Look Chan Ho, Creative Uses of Chapter 15 of the US Bankruptcy Code to Smooth Cross-Border Restructurings, [2009] Journal of International Banking Law and Regulation, 485.