ALERT MEMORANDUM

Schemes of Arrangement for Foreign Companies: Update and Overview

October 10, 2016

After years of expansion of the English Court's willingness to sanction schemes of arrangement for foreign companies, several recent cases suggest that a stricter approach may be applied in the future.

A number of decisions in the last year have sounded several warning notes:

1. The English Court may take more persuading that it is 'expedient' to sanction an English law scheme for a foreign company, particularly where only a few creditors are UK domiciled.
2. The form of jurisdiction clause found in many finance documents may be insufficient where only the debtor and not the creditors have submitted to the jurisdiction of the English Court.
3. Even absent dissenting creditors, the English Court may demand evidence of, and examine, lock-up agreements, consent fees, and other amounts paid to certain creditors as part of the restructuring to ensure that no class issue arises.
4. Increasing disclosure is being demanded, both to the court and to creditors in the explanatory statement and the practice statement letter.

An overview of the current law is attached at page 5.

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Background

For an English Court to assume jurisdiction and sanction a scheme for a foreign company, it will need to be persuaded of the following matters:

— First, that the court can take jurisdiction under English law on the basis that:

  • the scheme company has a sufficient connection with England;

  • the scheme would have substantial effect in the key relevant foreign jurisdictions; and

  • the EU Judgments Regulation does not limit the jurisdiction of the English court; and

— Secondly, that the court should exercise its discretion to sanction the scheme on the basis that:

  • the requirements of the Companies Act have been complied with, including that the classes of scheme creditors were properly constituted;

  • each class was fairly represented at the meeting and the majority acted in a bona fide manner and not coercively; and

  • the arrangement is one that an intelligent honest man acting in respect of his interest might reasonably approve.

In this memorandum, we focus on developments in relation to the EU Judgments Regulation and class composition where recent cases have highlighted a more rigorous approach taken by the English Court.

EU Judgments Regulation

One of the concerns in relation to scheme jurisdiction is whether the Judgments Regulation limits the scope of the scheme jurisdiction of the English court. If the Judgments Regulation applies, a scheme creditor domiciled in another EU member state is – in principle – entitled to be "sued" in that state as opposed to the UK. There has been some uncertainty as to whether the Judgments Regulation is engaged by a scheme, on the basis that it excludes "judicial arrangements", and talks of persons being "sued", language arguably ill-suited to the scheme context. In order to avoid having to decide on the applicability of the Regulation, the English Court has adopted the practice of assuming that it does, and going on to consider whether an exception to the rule above applies.

In this regard, a non-UK company will typically bring itself within the court's jurisdiction through Articles 8 or 25 of the Judgments Regulation.

To rely on the exception under Article 8, the scheme company needs to establish that at least one scheme creditor is domiciled in the UK and it is expedient to hear the claim in the UK to avoid the risk of irreconcilable judgments resulting from separate proceedings. Two distinct approaches are now being taken by the English Court in respect of Article 8.

One is the view that a single creditor domiciled in the UK is sufficient, and that a scheme will almost always be expedient, considering its purpose to bind all scheme creditors to the same restructuring. This view is supported by Justice Warren's statement in the convening hearing judgment concerning a scheme for hibu, where he noted that there was "no basis for imposing a precise threshold on the number or value of creditors who are required to be domiciled in the UK."

The other view is that an analysis of the number and value of UK creditors is necessary in order to determine whether it is expedient to hear the claims together. This approach suggests that a certain 'weight' in terms of number or value or both may be required for a scheme to be considered expedient. Such an approach was taken, for example, in the scheme sanctioned last year concerning a debt-for-equity swap by creditors of Dutch company Van Gansewinkel Groep BV.

The exact requirements of the latter approach are unclear. Despite seeming to demand a great number of creditors and/or value of claims, schemes concerning debt with a relatively small UK participation have been sanctioned under it. It is noteworthy that in the recent scheme for CBR Fashion GmbH in August 2016, Justice Asplin found that the court had jurisdiction under the Judgments Regulation in circumstances where just two scheme creditors holding 1.58% in value were UK domiciled.

To enable this closer scrutiny, the English Court expects to be provided with evidence of the

identities, holdings and domicile of the UK-domiciled creditors. This can be provided to the court on a confidential basis where such information is commercially sensitive.

Scheme companies may also seek to rely on Article 25 on the basis that the relevant debt document contained an English jurisdiction clause. In the case of Van Gansewinkel Groep, Justice Snowden found that a one-way jurisdiction clause in the facilities agreement whereby the company submitted to English jurisdiction for the benefit of the creditors was insufficient to engage Article 25. Justice Snowden also reached a similar "provisional" view in the Global Garden Products scheme.

Two counter-arguments can be made here. First, while the jurisdiction clause in Van Gansewinkel Groep merely states that "each obligor" submits to the exclusive jurisdiction of the courts of England, the typical formulation in an LMA loan agreement would say that "the Parties" (a term which would include the creditors) agree that the courts of England are the most appropriate and convenient courts to settle disputes. This should distinguish the jurisdiction clause in Van Gansewinkel Groep from the LMA jurisdiction clause.

Second, while such clause in a typical LMA loan agreement is usually "for the benefit of the Finance Parties and Secured Parties only", this should not negate the scheme creditors' submission to the jurisdiction of the English Court. Otherwise, it would be impossible to identify any jurisdiction where the scheme creditors can be sued if the scheme creditors can simultaneously object to being sued outside of England (by virtue of the submission to jurisdiction clause) and being sued in England (by virtue of the benefit of the debtor's submission to jurisdiction clause). Such reasoning would also contradict the conclusion in the earlier case in Vietnam Shipbuilding where the relevant clause was expressed to be "for the benefit of the Finance Parties only".

Class Composition

A scheme must be approved by the requisite majorities of creditors of each class. The classes of creditors should be comprised of creditors whose rights are not too dissimilar from one another to prevent them from consulting together with a view to their common interest. It is for the company to constitute the classes in the first instance, and it is the rights of creditors – both before and after the scheme – that should be considered.

Fees and Disclosure

In considering class composition, recent cases have shown that the English Court will be examining the multiple roles played in the scheme by individual creditors, particularly where they receive a fee for doing so (for example, fees granted in consideration of a creditor entering into a lock-up agreement). The existence of collateral benefits may mean that those who had accepted them may form a separate class.

In this regard, the English Court will look to see if any fees payable in connection with those roles are likely to have affected the creditors' decision to support the scheme. The fee needs to be sufficiently small so that it is unlikely to have a material effect on the decision of the a creditor to support the scheme. Again, the English Court is demanding more evidence on this point, including (in addition to the conventional topic-by-topic treatment of class composition issues) a supplement showing what cumulatively any particular creditor would gain from the restructuring as a whole where this differs from other creditors.

The English Court has also asked for the disclosure of the price at which scheme creditors acquired their debt in comparison to the fee payable. The reason is that if the debt was acquired at a significant discount in the secondary market (for example, 25 cents per US$1 nominal of the debt), an ostensibly small fee (for example, 2% of the nominal value) might nonetheless have a material effect on the decision of a creditor to support the scheme; if that were the case, such creditors may constitute a separate class for the purposes of the scheme.

The English Court has been willing to adjourn proceedings and thereby delay sanction of a scheme despite the commercial imperatives while evidence is located and brought to the court's attention. In consenting to a scheme in relation to Italian firm Global Garden Products, the Court required the company to adduce additional evidence of the

coordination fee paid to creditors. Such information – on the amounts paid and to whom and for what role – should therefore be made available not just to the court at the earliest stage, but also to scheme participants in the explanatory statement and the practice statement letter to avoid any delays in the implementation of the scheme.

Insolvency comparator

Where the scheme is presented as the alternative to insolvency, a greater amount of detail as to alternatives, and the company's reasoning alongside statements from auditors or financial advisors, should be included in the explanatory statement. Historically, the description of the insolvency comparator was achieved by including an express confirmation from the directors that they believe that the company would go into liquidation in the absence of a scheme and that the scheme presents a better outcome for the creditors; such confirmation would not usually be accompanied by any supporting materials. It is clear from, amongst others, the decision in Van Gansewinkel Groep, that it is expected that more detailed data and liquidation analysis, showing the expected recoveries of creditors, would be included in explanatory statements going forward.

While the recent cases have shown that the English Court has taken a more rigorous approach to certain aspects of schemes, the substance of the law has not changed significantly. The scheme of arrangement remains a powerful weapon in the restructuring armoury. It is clear that as judicial scrutiny increases, it is increasingly important to ensure that issues are brought to the court's attention at the first hearing, and that disclosure – to the court and the participants – is right the first time.

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Overview: Will an English Court take Jurisdiction?