DENTONS

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Pushing the envelope: the increased use of schemes of arrangement

KEY POINTS

- Schemes are becoming increasingly more accessible to non-English companies.
- Foreign companies can show a sufficient connection with the English jurisdiction solely by having finance documents governed by English law; reliance on COMI as an alternative is a notable development.
- Schemes are now being relied on for a variety of restructuring aims, including amending and extending facility repayment dates before any default occurs.
- A company can also consider applying for a stay of existing litigation against it while it proposes a scheme.

Schemes have become a useful and established procedure for restructuring the debts of foreign companies incurred under English law finance documents. They are increasingly being used by a wider group of non-English companies and for more sophisticated "compromises" than simple debt restructurings. In this article we aim to highlight a few of the recent developments.

BEYOND EUROPE

Until the end of 2012, in almost all reported schemes involving foreign companies, the company was European. The use of schemes by European companies is still going strong, but there has been a marked increase in the reports of non-European companies using schemes. These include companies incorporated in Kuwait (*Global Investment House KSC* [2012] EWHC 3792 (Ch)), Vietnam (*Re Vietnam Shipbuilding Industry Group* [2013] EWHC 2476 (Ch)) and Delaware, USA (*Re Icopal AS and others* [2013] EWHC 3469 (Ch)). The *Global Investment House* scheme was also the first involving Islamic finance documents and shows an increase in the use of schemes to restructure a wider variety of obligations.

THE JURISDICTION/FOREIGN RECOGNITION TESTS

Before sanctioning a scheme for a foreign company, the court has always needed to be comfortable that:

- it has jurisdiction to sanction the scheme;
- it is appropriate for it to exercise its discretion to do so, because the company's connection with the English jurisdiction is sufficient; and
- the scheme is likely to be effective and recognised in the foreign company's home jurisdiction.

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Recent schemes involving foreign companies have provided further clarity on an English court's (minimal) requirements for meeting these conditions. Courts have accepted jurisdiction where the only connection to England is that the relevant documents: (i) are English law governed; and (ii) include a jurisdiction clause (exclusive or non-exclusive) in favour of the English courts. In the *Vietnam Shipbuilding* scheme, the court suggested that the choice of English law to govern the relevant documents would have been enough on its own.

A company can usually satisfy a court on recognition if it can provide expert evidence that the relevant foreign jurisdiction(s) will recognise the scheme. However, international law firms should keep the comments of Richards J from the *Magyar Telecoms* scheme in mind: any expert foreign law evidence should come from an independent law firm to maintain transparency, not the foreign office of the same firm.

RELIANCE ON COMI TO SHOW "SUFFICIENT CONNECTION"

The starting point is to show that the company is a "company" within s 895(2) of the Companies Act 2006, ie, it is a company which the English courts have jurisdiction to wind up. This is readily satisfied because, in theory, all foreign companies are liable to be wound up by the English courts under s 221 of the Insolvency Act 1986. However, there are other questions that the court must still consider: is it appropriate for the court to sanction the scheme? Is the connection at this moment in time sufficient?

The recent approval of the scheme in *Re Magyar Telecom BV* [2013] EWHC 3800 (Ch) has focused on this final question. In doing so, the court has increased the possibility of showing a sufficient connection with the jurisdiction.

Magyar Telecom was incorporated in the Netherlands and its relevant financing documents were governed by the laws of New York. Three months before proposing the scheme, the company successfully migrated its COMI to England. This was instrumental in satisfying the court that the scheme should be sanctioned.

As the company had migrated its

COMI to England, English insolvency proceedings were a real possibility as an alternative to the scheme. On this basis, the judge considered that an English scheme made practical sense. If the alternative would be English insolvency proceedings, then there was an "obvious logic" in having an English reorganisation to try and prevent those proceedings.

This is the first time that COMI has been relied on to show a "sufficient connection". Given that the company had no other connection with the English jurisdiction, then this case potentially opens the way for more companies to use schemes. If a company plans ahead and has the sort of business where it is possible to migrate its COMI (such as *Magyar Telecoms* where a holding company was also the principal financing vehicle for the group), a successful COMI migration may increase the possibility of the English courts sanctioning the scheme, even if the governing law of the financing documents is not English law.

BEYOND BALANCE SHEET RESTRUCTURING

A company can use a scheme to put in place any "compromise or arrangement" with some or all of its creditors and members. Until recently, most schemes have involved at least an element of balance sheet restructuring, with the company already in default under the relevant finance documents. In contrast, the 2012 schemes of Spanish and Luxembourg companies in the Cortefiel Group involved no balance sheet restructuring, and no existing default (see *Re Cortefiel SA* [2012] EWHC 2998 (Ch)). Instead, the companies used the schemes to extend the maturity dates of their facilities, and amend certain other contractual terms, including the financial covenants, before any defaults occurred. Cortefiel used schemes to make these changes because it could not obtain consent from a sufficient percentage of its lenders using the amendment mechanics in its finance documents.

This shows how a borrower can use a scheme as a pre-emptive, turnaround measure. It is also a reminder that a scheme can potentially cut across minority lenders' contractual protections. Schemes require the approval of only 75% of the lenders in each class. However, this does not mean that companies can use schemes routinely to override "all lender" consent requirements. A scheme is a court-driven procedure. The court must consider it fair and reasonable to sanction the scheme before it will do so. Often, companies persuade the court of this "reasonableness" by showing that they will face insolvency if the scheme fails. Indeed, the court noted when sanctioning the *Cortefiel* scheme that, although the company was not yet in default, there was the prospect of a "severe cash flow crisis" if the scheme failed.

CLASSES AND LOCK-UP AGREEMENTS

Determining creditor classes is often the single most important factor when considering whether a scheme can succeed. The company will generally want the relevant creditors to be in a single class, or as few classes as possible. This makes it less likely that non-consenting creditors will hold 25% or more of the debt in any class, and so be able to block the scheme.

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Companies considering a scheme sometimes use "lock-up" agreements with creditors to try to ensure that the scheme will be approved. In these agreements, creditors usually agree to vote for the scheme, and receive some kind of extra payment in return. Do creditors who have signed these agreements need to be in a different class from those who have not?

Companies have previously successfully used lock-up agreements in a number of recent schemes, including *Primacom Holdings GmbH v Credit Agricole* [2011] EWHC 3746 (Ch) and *Re Seat Pagine Gialle SpA* [2012] EWHC 3686 (Ch), without having to create a separate creditor class. In these cases the court held that, provided the company had offered the lock-up agreement to all creditors, and the overall scheme was still fair, then no separate class was needed. The court also took into account that the additional payments promised under the lock-up agreements were fairly small. They had not materially affected the creditors' decisions on whether to vote for the scheme. Rather, the agreements were designed to avoid undue delay in voting.

The most recent reported challenge to the use of a lock-up agreements came in *Re Icopal AS* [2013] EWHC 3469 (Ch). In this case, minority lenders (who had not signed lock-up agreements) argued that creditors who had signed lock-up agreements should be separated into a different class as they were otherwise "forcing the majority views on the minority". When dismissing the application, the judge held that the dissenting creditors had failed to appreciate the real dangers that faced the company. The crux of the argument focused upon the alternative to the scheme. The company argued that the alternative was formal insolvency, the dissenting creditors argued it was not. The court held on the facts that insolvency appeared likely. As a result, all of the creditors had the same rights and could be included in the same class, whether they signed lock-up agreements or not.

In the absence of compelling evidence to the contrary, dissenting creditors will face an uphill evidentiary battle to disprove an assertion by the company itself that it is in the zone of insolvency. They

International Feature

Biog box
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will have little access to the company's financial information and, assuming a default has already occurred, a court will be likely to side with the cautious view of finding potential insolvency.

SCHEMES AND STAYS

Companies do not benefit from an automatic moratorium while a scheme is being progressed. This can be a major pitfall and is often the reason why schemes have been limited in their usage. A company will often try to get its creditors to sign up to a standstill agreement during this period. However, it may be particularly difficult to persuade those who disagree with the proposed scheme to do so and any such standstill will be ineffective without all lender consent.

However, in the recent case of *Bluecrest Mercantile NV v Vietnam Shipbuilding Industry Group* [2013] EWHC 1146 (Comm), the court granted a company a stay on proceedings that, prior to it proposing the scheme, had been launched by dissenting creditors for repayment of overdue amounts. The court agreed to exercise its discretion and order a stay on the basis that the scheme was well advanced and the stayed proceedings had not yet reached judgment.

The stay granted in *Vietnam Shipbuilding* is the first reported case of its kind, and so it is difficult to predict how willing the courts will be to grant stays in connection with schemes where the circumstances are different. Indeed, in this case, the court noted that once a creditor receives judgment, a stay is unlikely to be granted. However, the decision does suggest that it may be possible in some circumstances for a company to obtain an effective moratorium for any ongoing litigation while it finalises its scheme. This is yet another example of how schemes are continuing to advance in sophistication, cementing their place as a powerful restructuring tool.