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Schemes of Arrangement: flexible, global and here to stay

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Over some 150 years of use, the English scheme of arrangement has become a well established restructuring mechanism used in a variety of contexts, notably to write off debt in a broadly tax neutral manner, and to effect debt for equity swaps and debt instrument exchanges. But the scheme is more flexible than even that broad range of transactions suggest. This article explores two noteworthy areas in which schemes have recently been deployed.

Amend and extends

In October 2012, a new use for schemes emerged with the sanctioning of the *Cortefiel* scheme, which was used to implement an 'amend and extend' of the Spanish clothing retailer's facilities, rather than a balance sheet restructuring. This type of scheme was also used in the cases of two multi-jurisdictional roofing groups in 2013: Icopal (a Danish group also including French and US companies) and *Monier* (which involved schemes of 13 principal borrowers incorporated in Germany, France, Italy, the Netherlands and the US, in addition to England).

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Neither *Cortefiel* nor *Monier* had succeeded in obtaining the level of lender consent required to extend the maturity of their facilities by way of the usual consensual route. While some facilities require unanimous lender consent to extend the maturity of any facility, in other LBO debt structures with a number of layers of facilities, the consent threshold required to extend the maturity of a facility requires both a majority (typically 66.67 percent) of all lenders, together with the consent of each lender under the affected facility.

In consequence, in the past many borrowers have either been unable to extend maturities, or (depending on the applicable amendment thresholds) have been forced into the somewhat unsatisfactory compromise of leaving a stub of lender hold-outs on the old terms and resulting in an inequality of treatment within the syndicate.

Despite a generally high level of support among lenders in *Cortefiel* and *Monier* for the consensual amend and extend proposals, each company ultimately decided to go down the route of implementing an English-law scheme. Having already theoretically fulfilled the statutory test required in order to implement a scheme (i.e., the approval of a majority in number representing at least 75 percent in value of each class of creditor voting on the scheme), each borrower could be fairly certain that the schemes would be approved, and both also entered into to the usual lock-up arrangements with lenders to ensure the required levels of support.

The key advantage of a scheme in this context is that the approval of the statutory majorities of creditors binds any dissenting minority, and an amend and extend may therefore be implemented across the syndicate, providing consistency and clarity and leaving no hold-outs on old terms. In both *Cortefiel* and *Monier*, this minority included CLOs (which are typically restricted from consenting to any maturity extension, and therefore from voting in favour of, or even from voting on, a scheme). It remains to be seen in future whether a scheme may be challenged, potentially on unfairness grounds, due to such CLO restrictions.

Global reach

The second exciting trend in scheme evolution is the gradual but steady progression of cases in which English-law schemes are being sanctioned in respect of companies which are not incorporated or based in the UK. This evolution gathered speed with *Rodenstock* and *Primacom*, in which it was established that companies incorporated in another EU member state (Germany) and with their centre of main interests (COMI) outside the UK nevertheless had a 'sufficient connection' with the UK. In these cases the fact that the facility documents were governed by English law with exclusive English jurisdiction clauses was held to be sufficient to give the English courts jurisdiction to sanction schemes compromising such facilities.

Another step forward was taken in the recent case of *Vinashin*, in which a scheme of a Vietnamese company was sanctioned on the basis of English-law governed facilities. That was by itself sufficient to establish the necessary connection with England, even though the jurisdiction clause was non-exclusive in favour of the English courts.

The most recent development took place in the case of *Magyar Telecom*, in which the English court sanctioned a scheme of a company incorporated in the Netherlands whose main business was operated in Hungary, on the basis that the company's COMI was in England. This case broke new ground as the scheme compromised bond debt governed by New York law, with documentation containing a non-exclusive New York jurisdiction clause.

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The company had moved its COMI to England before it proposed the scheme. Because the only practical alternative to the scheme was insolvency, and that insolvency process would take place in England (due to the location of the company's COMI), there was an 'obvious logic' in treating a scheme approved under English law as effective to alter the rights of creditors, even though those rights were governed by New York law. This reasoning was followed recently in the *Zlomrex* case, where a French financing vehicle was held to be eligible to avail of a UK scheme on the basis that steps taken to move the company's COMI to England had been significant in establishing a sufficient connection with England. The sanctioning of the *Magyar Telecom* and *Zlomrex* schemes has therefore unveiled a new horizon of schemes: namely to restructure high yield bond debt issued under New York-law governed documentation.

Throughout this evolution, it has become clear that certain ingredients are vital in order for the English courts to assert jurisdiction to sanction a scheme of a foreign company: (i) the company must be 'liable to be wound up' under the Insolvency Act 1986; (ii) independent expert evidence that the scheme will be recognised and given effect to in the foreign jurisdiction, or jurisdictions, in question must be obtained; (iii) a sufficient connection with England must be demonstrated (this could be via assets in the jurisdiction, the presence of a sufficient number of creditors in England, English-law governed finance documents and/or a finding that the company's COMI is in England); and (iv) evidence that the scheme will achieve its purpose must be provided (which the court in *Magyar Telecom* considered to be closely related to point (iii) above, if not actually part of the same question).

A number of questions remain in respect of schemes. Notably, Article 2 of the Judgments Regulation might affect the English court's jurisdiction in some cases involving solvent schemes, because it gives exclusive jurisdiction to the courts of the member state in which a majority of scheme creditors are domiciled. This question has not yet been fully considered by the courts. Further, it remains to be seen whether the English government will follow the suggestion to include schemes in Annex A of the amended EC Insolvency Regulation, which would substitute a more burdensome COMI test for the present flexible sufficient connection measure.

Although these questions remain and a well-founded creditor challenge to a scheme may now be overdue, it is clear that there is a bright future ahead for English-law schemes of arrangement, in restructurings and beyond. ■

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