

English Schemes of Arrangement: Points to Note From a Recent Example

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Cleary Gottlieb Steen & Hamilton LLP recently represented Far-Eastern Shipping Company plc, a public company incorporated in Russia, and certain of its affiliates in their restructuring of over USD 1 billion of debt. Part of the restructuring involved the negotiation of a compromise arrangement with certain noteholders under two series of EU listed U.S. dollar-denominated Eurobonds with trust deeds governed by English law. The compromise was implemented by way of an English law scheme of arrangement which was convened with the permission of the High Court of Justice in October 2017 and sanctioned in November 2017.

This memorandum provides an insight on a number of issues that were explored at the convening and sanction hearings. Of particular note was the court's consideration of the interplay between the EU Judgments Regulation and EU Insolvency Regulation.

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1. Changes to the European insolvency framework

The English courts are often seen as the destination of choice for distressed foreign companies wishing to restructure their indebtedness. Many overseas companies restructure their debt by way of English law scheme of arrangement. The scheme of arrangement is a tool which gives the English court the power to sanction a compromise or arrangement with a company's creditors subject to the approval of the compromise by a majority in number and 75 per cent in value of each class of creditors. Prior to sanctioning a scheme of arrangement, the English court will need to be persuaded that there is a sufficient connection to England and Wales in order to accept jurisdiction.

Two jurisdictional questions frequently arise in respect of schemes of arrangement. The first is whether the court is satisfied that the company proposing the scheme is a company "*liable to be wound up under the Insolvency Act 1986*".¹ For overseas companies with separate legal personality and limited liability for their members, this is not a difficult test to satisfy.

The second, and more frequently debated, question is whether there are any limits or restrictions as a matter of EU law on the English court's jurisdiction in a scheme and this question was considered again in the present case, where the scheme company was a Luxembourg entity with its centre of main interests ("**COMI**") in Luxembourg. In such circumstances, the court must consider whether the EU Insolvency Regulation² or the EU Judgments Regulation³ (the "**Regulations**") would limit the ability of the English court to exercise its jurisdiction in respect of the scheme company.

The EU Judgments Regulation applies to "*civil and commercial matters, whatever the nature of the court or tribunal*,"⁴ while specifically excluding the following from its scope: "*bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings*."⁵ At the same time, schemes of arrangement have not typically been considered to fall within the EU Insolvency Regulation.⁶ Whilst Annex A to the Regulation (setting out the proceedings that fall within its ambit) does include "*voluntary arrangements under insolvency legislation*", the view is often taken that a scheme of arrangement is not *per se* an insolvency procedure that would fit into this category or the EU Insolvency Regulation more generally. Were schemes of arrangement to be included within the list of proceedings governed by the EU Insolvency Regulation, companies not incorporated in the UK would need to shift their COMI to use a scheme.

It appears to have been the intention of the drafters of the precursors to the EU Insolvency Regulation and the EU Judgments Regulation that the two regimes should "*dovetail almost completely with each other*."⁷ However it was recognised that such alignment might not be possible in every circumstance. Schemes of arrangement were initially included in the list of proceedings to be annexed to the draft bankruptcy convention (which was abandoned before it could come into force and was later superseded by the immediate precursor to the current insolvency regulation).⁸

The analysis of the Regulations by the English courts has historically been premised on this view, i.e., that "*there can be no gap between the Judgments Regulation and ... the Insolvency Regulation*,"⁹ favouring the EU Judgments Regulation as the one

¹ Section 895(2), Companies Act 2006.

² Council Regulation (EC) No. 1346/2000 on Insolvency Proceedings recast by Regulation (EU) 848/2015 of the European Parliament and of the Council on Insolvency Proceedings.

³ Council Regulation (EC) No. 44/2001 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters recast by Regulation (EU) 1215/2012 of the European Parliament and of the Council on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters.

⁴ Article 1(1), Judgments Regulation.

⁵ Article 1(2)(b), Judgments Regulation.

⁶ Re Van Gansewinkel Groep BV [2015] EWHC 2151 (Ch).

⁷ Report of Professor Dr Peter Schlosser on the Convention (October 1987) (No C59/71), para. 53. The precursor to the Recast Insolvency Regulation was the draft Bankruptcy Convention.

⁸ *ibid.*, Annex I.

⁹ Re Van Gansewinkel Groep BV [2015] EWHC 2151 (Ch) at 44 and Re Rodenstock GmbH [2011] EWHC 1104 (Ch).

encapsulating the schemes without however making any ultimate conclusions as to its applicability and instead trying to find exemptions within the EU Judgments Regulation that would allow for the exercise of the court's jurisdiction.

The approach, which has received qualified support in the case law of the European Court of Justice, has satisfied the English courts that there are no limitations to the exercise of its jurisdiction.¹⁰

Even though (and consistent with past practice) in *FESCO* Mr Justice Snowden refrained from concluding whether or not the EU Judgments Regulation applies to schemes of arrangement (and instead analysed the exemptions that might apply if one were to assume that the EU Judgments Regulation does apply) he did scrutinise the fundamental premise of this analysis of the two Regulations in view of the recast of the EU insolvency regulation.

Recital 7 of the recast EU Insolvency Regulation states that: “*the fact that a national procedure is not listed in Annex A ... should not imply that it is covered by Regulation (EU) No 1215/2012 [the Judgments Regulation].*”¹¹

Mr Justice Snowden noted that the additional language in recital 7 may have only suggested that the exclusion of a scheme of arrangement from the EU Insolvency Regulation does not automatically lead to its inclusion within the EU Judgments Regulation. The additional wording in recital 7 of the Recast Insolvency Regulation does not, however, exclude the possibility that schemes will be entertained under the jurisdictional gateways in the EU Judgments Regulation.

In the recent *German Graphics* case the European Court of Justice noted that “*it is conceivable that ... there are some judgments which will not come within the scope of application*” of either regime.¹² Were it to be successfully argued that a scheme of arrangement did not fall within either regime, an English court would have to determine whether it

could exercise its jurisdiction in respect of an overseas company, but would also have to satisfy itself that the scheme of arrangement would be recognised overseas (or at least in the jurisdictions in which the scheme company had its COMI; had material operations or had given security under a financing for example).

With respect to jurisdiction, the courts have made it clear that “*neither the Judgments Regulation nor the Insolvency Regulation has narrowed the court's jurisdiction in relation to schemes*”¹³ as the court ultimately has to determine whether the scheme company was liable to be wound up under the Insolvency Act 1986. In this regard, the court's power to wind up a company extends to overseas companies by virtue of statute.¹⁴

When considering recognition of proceedings which are not within scope of either regime, two approaches could be considered. The scheme of arrangement could be “shoehorned” into Article 4 of the EU Judgments Regulation by identifying the domicile of intended defendants. Such an exercise may involve an uneasy analysis of whether a scheme of arrangement sought to deprive a creditor of their rights against the company. Alternatively, member states of the European Union could “*continue to apply [their] own private international law*” to effect recognition.¹⁵ Following the end of any transition period associated with the United Kingdom's departure from the EU, overseas companies may be left with no choice but to rely on the second formulation.¹⁶

2. Schemes of arrangement: judgment or settlement

Prior to sanctioning a scheme of arrangement, the English courts will want to ensure that a scheme order is enforceable in another relevant jurisdiction. Expert evidence is typically adduced from the scheme company's jurisdiction of incorporation and/or jurisdictions where the scheme company has substantial assets which could have claims attached to them in an insolvency scenario.

¹⁰ *Nickel & Goeldner Spedition GmbH v “Kintra” UAB* (Case C-157/13) at 21 and *Comité d'entreprise de Nortel Networks SA V Rogeau and others* (Case C-649/13) at 26.

¹¹ Recital 7, Recast Insolvency Regulation.

¹² *German Graphics Graphische Maschinen GmbH v Alice van der Schee* [2009] (Case C-292/09).

¹³ *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch) at 56.

¹⁴ See section 221(1), Insolvency Act 1986.

¹⁵ *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch) at 61.

¹⁶ At the time of publication, the UK government and European Commission had separately signalled their intention to create a transition period during which the Regulations would continue to apply in the UK.

With respect to companies incorporated in other member states of the European Union, expert opinions often analyse the EU Judgments Regulation when considering whether or not the order sanctioning a scheme will be enforced in the relevant jurisdiction. The question that arose in FESCO (and sparked by the expert evidence from one of the EU jurisdictional experts) represents a further uncertainty in the EU Judgments Regulation with respect to which category a scheme order would fall under if the EU Judgments Regulation were to apply: either as a judgment or a court settlement.

A court settlement is defined as “*a settlement which has been approved by a court of a Member State or concluded before a court of a Member State in the course of proceedings.*”¹⁷

Without making any firm conclusions with respect to the applicability of the EU Judgments Regulation overall, Mr Justice Snowden’s view that a scheme is not a court settlement within the Regulation’s meaning was unequivocal. He found that a scheme of arrangement “*is very different from the consensual settlement of a claim which is blessed by the court.*”¹⁸ He noted that if a company proposed a scheme of arrangement and it received the consent of all relevant creditors there would be no need to “*darken my [the court’s] door.*”¹⁹ He further noted that it was not the role of the court to merely “*rubber stamp*” such arrangements and referred to Lord Hoffmann dictum that there were three elements: the company’s proposal; the creditor’s consent and the sanction of the court which is given “*binding force*” by statute.²⁰

In light of the above, it is necessary to draw the distinction between a scheme of arrangement, which is a restructuring tool proposed by the scheme company; voted on by the scheme creditors and sanctioned by the court; and a court settlement, which may be agreed between two or more parties and merely approved by the court.

The court’s function in sanctioning a scheme of arrangement is, therefore, to satisfy itself that:

- the provisions of the Companies Act 2006 have been complied with;
- that the scheme creditors (or each class of scheme creditors if there was more than one class) were fairly represented at the scheme creditor meetings;
- that the scheme of arrangement is one that an intelligent and honest person might approve; and
- that there is no blot or other problem on the scheme.

For further detail on the procedure concerning schemes of arrangement, please see our earlier alert memorandum: [Schemes of Arrangement for Foreign Companies: Update and Overview](#).

3. Evidence of domicile of scheme creditors

In analysing the exemptions under the EU Judgments Regulation, the English courts often rely on Article 8(1) of the Regulation, concluding that a non-English scheme creditor may be sued in the English courts together with creditors domiciled in England on the basis of “*the claims [being] so closely connected that it is expedient to hear and determine them together.*” The question then arises of how scheme companies provide evidence to the court of such domicile in England.

Determining the identity of scheme creditors may be difficult in the context of restructuring indebtedness under publicly traded bonds. In a typical bond structure, there is no contractual nexus between the issuer of securities and the underlying investors or the ultimate beneficial holders of the notes. Pursuant to the terms of the notes, the holder of the notes is the one entered in the register maintained for that purpose which, unless and until a definitive note is issued to a particular beneficial owner, will be a person in whose name a global note is registered.

The global notes are registered in the name of nominees for the clearing system. The ultimate beneficial owner may be a direct participant or account holder in the clearing system, but typically

¹⁷ Article 2(b), Judgments Regulation.

¹⁸ Hearing Transcript, page 72.

¹⁹ *ibid.*

²⁰ *Kempe v Ambassador Insurance Company* [1997] UKPC 55 at 12.

they are behind a number of further intermediary layers with each layer being subject to its own contractual (and jurisdictional) framework.

Pursuant to a trust deed the holders of the notes would further be prohibited from taking independent enforcement actions against the issuer, requiring such actions to be taken via the trustee. Technically, the trustee is the legal owner of any claim against the issuer and any enforcement action with respect to the notes should, in theory, be directed by the trustee. In the context of a scheme of arrangement involving publicly traded debt, the courts will tend to look at whether the ultimate beneficial owners of the notes have provided the relevant statutory consents.²¹ Similarly if the scheme company is adducing evidence of the domicile of scheme creditors, they would typically do so with respect to ultimate beneficial owners rather than the trustee. Indeed the trustee will typically not be considered a scheme creditor for these purposes or if so considered will expressly refuse to vote one way or another.

The complexity of the chain of intermediaries as well as the confidentiality restrictions affect the issuer's ability to have a precise record of the ultimate beneficial holders, thus, requiring it to rely on "self-certification".

Market practice has developed to use a form of account noteholder letter in which the relevant account holder completes and certifies their country of residence (or if a corporate, incorporation). The judge in this case confirmed that such information can be aggregated and provided to the court to show the percentage of scheme creditors domiciled in England and Wales for the purposes of determining jurisdiction. Care should be taken however that the form of the account holder letter is clear on its face when requiring this certification and consistent with Article 63 of the EU Judgments Regulation which provides that domicile is determined by reference to a company's registered office; place of central administration or principal place of business.

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²¹ Re Magyar Telecom B.V. [2013] EWHC 3800 (Ch.) at 26.