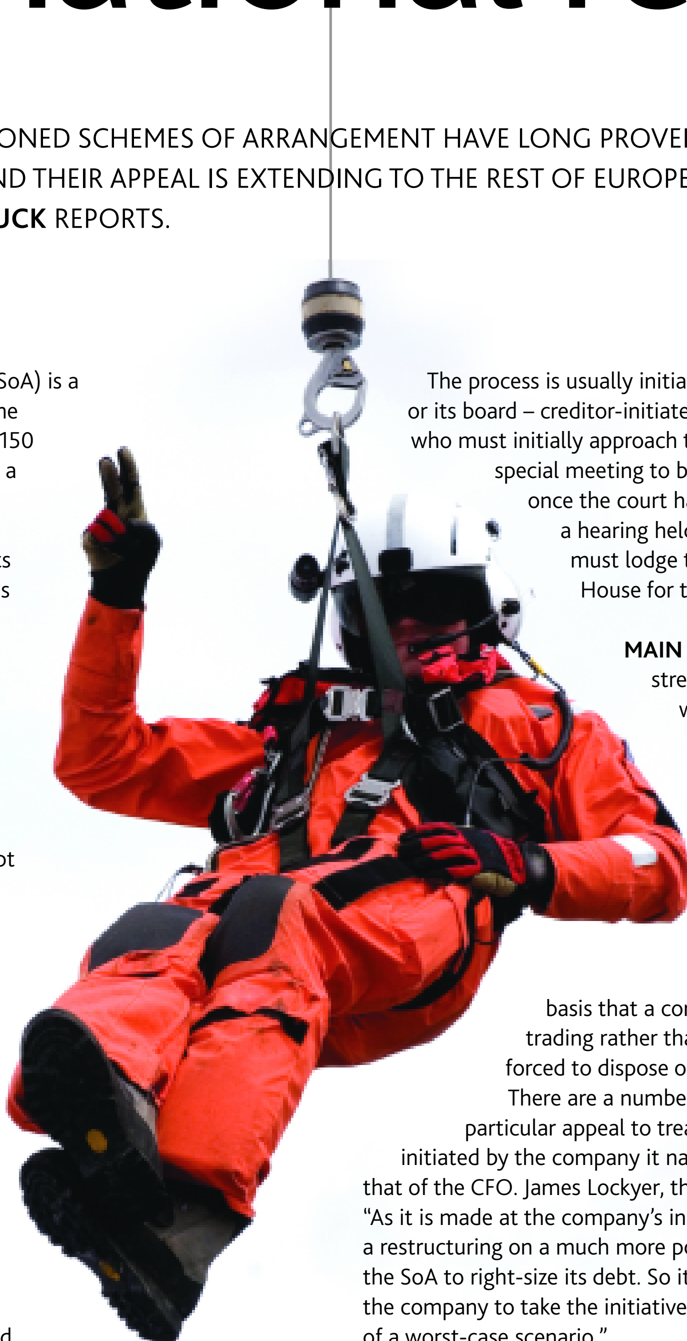
International rescue

COURT-SANCTIONED SCHEMES OF ARRANGEMENT HAVE LONG PROVED USEFUL TO UK COMPANIES, AND THEIR APPEAL IS EXTENDING TO THE REST OF EUROPE AND BEYOND, AS **GRAHAM BUCK** REPORTS.



The scheme of arrangement (SoA) is a concept that dates back to the Victorian era, and for nearly 150 years has been employed for a variety of purposes. As a court-sanctioned agreement between a company and either the holders of its securities or its creditors, the SoA has proved popular with companies as a vehicle for rescheduling their debt (to avoid insolvency), completing an acquisition or returning capital. And because SoAs can be used to eliminate very long-term obligations, insurers have used them on large books of business by compelling policyholders to accept a one-off payment for which they relinquish their right to make any further claim on an expired policy.

In a restructuring context (and SoAs are also commonly known as schemes of reconstruction), implementing an SoA, which is made possible through the Companies Act 2006 and its predecessors, is a court process. It binds a company's consenting and non-consenting creditors to a proposed restructuring when that restructure has been approved at a specially convened meeting by at least 75% by value and more than 50% in number of each relevant class of those creditors voting at the meeting (or each meeting where there is more than one class of creditor).

A company can therefore use an SoA to put restructuring measures into effect without having first to secure the unanimous approval of all its creditors even where the terms of its facility, intercreditor agreement or other finance documents require unanimity.

The process is usually initiated by the company's management or its board – creditor-initiated SoAs are rare in restructuring – who must initially approach the court to secure directions for a special meeting to be convened. Subsequently, and once the court has sanctioned the proposed SoA at a hearing held for the purpose, the company must lodge the sanction order with Companies House for the SoA to become effective.

MAIN STRENGTH One of the main strengths of an SoA is that a company with a heavy debt load can use it to achieve a compromise with its creditors, thereby addressing its problems and maintaining the business as a going concern potentially able to avoid insolvency proceedings. This state of affairs should benefit creditors as well as shareholders, on the basis that a company is more valuable if it keeps trading rather than becoming insolvent and being forced to dispose of its assets.

There are a number of features within an SoA of particular appeal to treasurers. As the process has to be initiated by the company it naturally falls within their remit, or that of the CFO. James Lockyer, the ACT's director of education, says: "As it is made at the company's instigation, the business can go into a restructuring on a much more positive basis – for example, using the SoA to right-size its debt. So it presents a good opportunity for the company to take the initiative and act before it reaches the stage of a worst-case scenario."

RESORTING TO THE ENGLISH COURTS An interesting recent development has seen distressed borrowers in mainland Europe and beyond resorting to the English courts to put through plans to reduce their debt load and avoid local insolvency proceedings. Several companies have demonstrated that an SoA can be used by a non-UK company, regardless of domicile, to put through a restructuring because its loan documentation is governed under English law.

A wide range of purposes

Schemes of arrangement can be an invaluable corporate finance tool in the right hands, *writes Peter Williams*. In March this year Uniq, the chilled convenience food producer, announced that its scheme of arrangement for restructuring the company had received court approval.

As a result of the SoA and the subsequent restructuring, 90% of Uniq's equity has been transferred to a specially incorporated vehicle and sold for the benefit of the defined benefit part of Uniq's pension scheme. The shareholders in Uniq were left with 10% of their previous holding in Uniq's equity, and Uniq and its subsidiaries will be released from their obligations to the defined benefit part of the pension scheme.

The SoA provided a solution to the financial problems posed by the deficit on Uniq's pension scheme. Without the SoA, Uniq described the possible outcomes in a circular to shareholders: "Several detrimental events are likely to take place, including, most significantly, that the trustee [of the pension scheme] and the Pensions Regulator would seek at least the minimum level of pension contributions needed to ensure that the pension funding position does not deteriorate further, which [Uniq] is unlikely to be able to afford; or, alternatively, the trustee and the Pensions Regulator would seek to recover the full pension deficit, which is in excess of £400m, on the basis of the valuation assumptions adopted by the trustee. Each of these events would, in all likelihood, result in [Uniq] becoming insolvent."

This seems to have been the first time that an SoA has been used to transfer most of the equity of a listed company out of the hands of shareholders and into a special purpose vehicle, so that the equity could then be sold for the benefit of the listed company's pension scheme. As the judge who sanctioned the scheme observed: "The [scheme] is further evidence of the utility of SoA as a means of achieving a wide range of purposes including, as in this case, securing the long-term future of a company or group which would otherwise in due course face insolvency."

"There has been a common misconception that the English SoA procedure requires the company to have an actual physical presence here," says John MacLennan, a partner in the restructuring and insolvency group at law firm Clifford Chance. "However, the test that applies in determining whether an English court can sanction an SoA for a non-UK company is whether that company is 'liable to be wound up' here. The answer to this rests on several issues, including perhaps most importantly whether the company has a 'sufficient connection' with this country."

Successful examples include specialist foams and plastics producer Vita Group and its controlling shareholder TPG Capital, which in 2009 used an English court-sanctioned SoA for a financial restructuring to reduce the group's debt load of more than €600m to around €180m. Under the deal, an equity stake of 40% in Vita, a company incorporated in Luxembourg, and €95m of new secured debt were provided by a group of new lenders, including TPG Capital, which remained the largest single shareholder.

Although the restructuring and new financing was a complicated deal, involving complex debt, shareholder and warrant documentation

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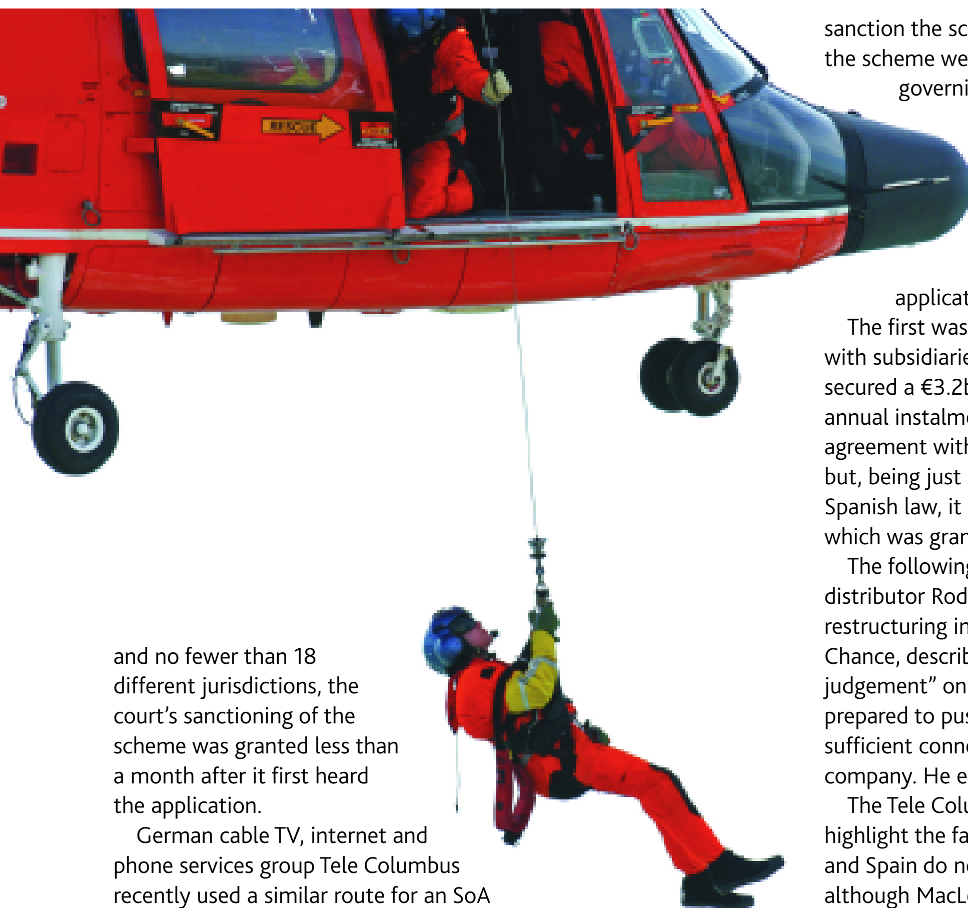

and no fewer than 18 different jurisdictions, the court's sanctioning of the scheme was granted less than a month after it first heard the application.

German cable TV, internet and phone services group Tele Columbus recently used a similar route for an SoA to restructure through a partial debt for equity swap, an amendment of the senior, second lien and mezzanine facilities agreements and new finance. The group had initially proposed to give lenders an equity stake in return for reducing its debt load by around a third, from €947m to €623m, but failed to secure unanimous consent.

Last December the English courts sanctioned four connected schemes of arrangement relating to the English law debt obligations of Tele Columbus. The approval was based partly on the court being satisfied on two distinct issues. First, there was sufficient connection to England and Wales because the finance documents were governed by English law and subject to the exclusive jurisdiction of the English courts. Second, the expert evidence provided a strong case for the scheme having "a substantive and useful effect" in that the changes it implemented would also be recognised by the German courts on the basis of German private international law, so dissenting creditors could not circumvent the scheme by taking action in Germany.

"In the case of Tele Columbus, the group is German but the English court was satisfied that there was no equivalent or similar procedure under German law for effecting a restructure outside of insolvency," says MacLennan. "If there had been, the court might have refused to sanction the scheme. And as the debts being restructured through the scheme were governed by English law and the arrangements governing such debts gave the English courts, for the benefit of the lenders, exclusive jurisdiction, it was appropriate that they be compromised by this English law mechanism."

As Tele Columbus's application was uncontested before the court it went largely unreported in the media; as did two even more recent applications to the English courts.

The first was by Metrovacesa, a Spanish property holding company with subsidiaries in Spain, France and Germany. Metrovacesa had secured a €3.2bn loan in June 2006, with repayment due in three annual instalments commencing June 2011. The group reached agreement with nearly all its creditors to reschedule the repayments but, being just short of the 100% creditor agreement required under Spanish law, it successfully applied to the English courts for an SoA, which was granted in April.

The following month, German spectacles manufacturer and distributor Rodenstock received permission for a proposed restructuring in the form of an SoA. Philip Hertz, a partner in Clifford Chance, describes the Rodenstock decision as "the first fully reasoned judgement" on the issue of SoAs and shows the English courts are prepared to push the "jurisdiction envelope" on what constitutes sufficient connection for sanctioning an SoA relating to a foreign company. He expects it to facilitate further similar restructurings.

The Tele Columbus, Metrovacesa and Rodenstock deals all highlight the fact that mainland Europe countries such as Germany and Spain do not offer the SoA option as an alternative to insolvency, although MacLennan adds that Spain is planning to introduce a pre-insolvency compromise process.

SOA TREND In the meantime, banks are increasingly reluctant to lend and Basel III will require them to be more selective both in who they lend to and the rate applicable. It's very likely that fewer will grant waivers on loans and more non-UK companies and their treasurers may resort to applying for an English law SoA for rescheduling or restructuring their debt.

"With any process that involves arrangements with creditors, there will be perceived winners and losers," says Lockyer. "But it is far better to act while the company is still a going concern rather than wait until insolvency is imminent.

"Schemes of arrangement potentially provide a lot more flexibility, and a simpler, more structured route to rescheduling or restructuring debt. As the company is still viable, it avoids the accusations that often follow insolvency of certain creditors getting preferential treatment over others." For example, had Eurotunnel secured an SoA prior to its bankruptcy in 2006 when creditors failed to approve its restructuring plan, it might have resulted in fewer disgruntled bondholders.

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