ALLEN & OVERY

Restructuring Across Borders

England and Wales:

Schemes of arrangement, restructuring plans and voluntary arrangements | October 2020

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Contents

Introduction

Where a company is essentially profitable but its debt and interest burden are too great, it may be able to persuade its creditors to convert some of their debt into equity or to reschedule its payment obligations by extending the maturity/payment dates and to continue funding the company. This is a simple example of a restructuring which may be effected through a voluntary arrangement, a scheme of arrangement or a restructuring plan. Restructurings can be pursued through the formal procedures set out in the Insolvency Act and the Companies Act, but can also be effected on a simple contractual basis and many rescue and support operations are conducted out of court in this way.

Although schemes of arrangement and company voluntary arrangements have been around for many years, the restructuring plan is a new creation of English law, having been introduced in June 2020.[1] While there is very little case law in relation to restructuring plans, there is a great deal of similarity between restructuring plans and schemes of arrangement, save that a restructuring plan permits a cross-class cram down, which is not available in a scheme of arrangement. We therefore expect that the case law principles that have developed in relation to schemes of arrangement will also be applied to restructuring plans.[2]

[1] For more information on how the restructuring plan could change the ways in which cross-border restructurings are structured and implemented in the UK and across Europe, please find our detailed analysis **here**.

[2] *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2191 (Ch) and [2020] EWHC 2376 (Ch).

Schemes of arrangements and restructuring plans

Both a scheme of arrangement and a restructuring plan are formal arrangements between the company and its creditors and/or its members (or a class of its creditors or members) which, when approved by the relevant creditors or members (as appropriate) and sanctioned by the court, becomes binding on them all.

The procedures are provided for under Part 26 (sections 895-901) (for schemes of arrangement) and 26A (sections 901A-901L) (for restructuring plans) of the Companies Act 2006. Neither is an insolvency procedure as such (ie under the Insolvency Act 1986), although in order to propose a restructuring plan, a company must have encountered, or be likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern. And while not insolvency procedures, both may be used by a company in financial difficulty to reach a binding compromise or arrangement with its creditors and/or members.

The terms of the arrangement will vary from case to case; it is essentially a commercial deal between the company and its creditors and/or members. A scheme or plan can only impact the rights of counterparties in their capacity as creditors. A scheme or plan could, for example, vary the contractual rights of creditors including the amounts owed to them, the repayment dates or the methodology for determining their claims, and/or involve a complete write-off of debt and/or a debt for equity swap. However, as with CVAs (as discussed below) neither schemes of arrangement nor restructuring plans can affect proprietary rights without consent. Therefore, for example, the rights of landlords to forfeit their property on the occurrence of an insolvency-related event (if applicable) may not be altered by a scheme or a plan.[3] Also, where a scheme or a plan is proposed within 12 weeks of the end of the statutory moratorium, it cannot compromise moratorium debts (ie debts incurred during the moratorium under arrangements entered into during the moratorium) or priority pre-moratorium debts (ie the monitor's remuneration or expenses, goods or services supplied during the moratorium, rent for a moratorium period, wages or salary and certain redundancy payments etc). Schemes of arrangement have also been utilised to effect a moratorium or standstill on creditors, meaning a temporary suspension on the ability of creditors to exercise certain of their rights, however, this may not now be necessary given the introduction of a statutory moratorium under Part A1 of the Insolvency Act 1986. That said, a scheme of arrangement may still be useful to impose a moratorium or standstill on financial creditors, who are largely sheltered from the effects of the moratorium under Part A1 of the Insolvency Act 1986 and have wide powers to bring such a moratorium to an end. The statutory moratorium can be used in conjunction with both a scheme and a plan and the court has the power (under section A15 of the Insolvency Act 1986) to extend the moratorium for the duration of a scheme or plan.

[3] Re Instant Cash Loans Ltd [2019] EWHC 2795 (Ch).

Procedure

Negotiating the terms of the scheme or plan with creditors and drafting the scheme or plan documentation is the first step. Typically, the terms will be formulated over a number of months of commercial negotiation and it is not uncommon for indicative heads of terms or proposals setting out the principles to be included in the scheme or plan to be drawn up prior to the scheme or plan documentation itself being drafted. This can be a lengthy and complex process, depending on the nature of the creditors and the debt and jurisdictions involved. Once the scheme/plan documentation has been drafted, obtaining approval and sanction of the scheme of arrangement or restructuring plan is the next step – a three-stage process.

An indicative timeline of the key steps for both a scheme of arrangement and a restructuring plan process can be found in **Appendix 1**.

Convening the meetings

Both a scheme of arrangement and a restructuring plan are formally commenced by an application to court seeking a court order that the company should convene the relevant meetings of creditors and/or shareholders. The initial court hearing to consider this application is referred to as the "convening hearing".

The two primary purposes of the convening hearing are for the court to establish whether it has jurisdiction (including, in relation to a restructuring plan, whether the entry condition that the company must currently be in or likely to suffer from financial difficulties) in relation to the proposed scheme of arrangement or restructuring plan and, if such jurisdiction is established, to determine the constitution of classes of creditors and/or members and therefore how many creditor or member meetings ought to be convened.

The test for establishing jurisdiction for a scheme of arrangement and a restructuring plan is whether there is a "sufficient connection" between the company proposing the scheme or plan and England and Wales. Such sufficient connection may be established in a variety of ways, for instance by the company having assets in England and Wales or an establishment, place of business or its centre of main interests in England and Wales, but it can also be founded on the basis that any obligations to be compromised by the scheme of arrangement or restructuring plan are governed by English law or that under the relevant contractual arrangements the parties have submitted to the jurisdiction of the courts of England and Wales.

Where assets are located in foreign jurisdictions or scheme or plan companies are incorporated outside of England and Wales, in addition to establishing sufficient connection, the court will also require evidence that the scheme or plan is likely to be of some effect (ie it would be recognised by the courts) in those jurisdictions and, for this purpose, opinions are usually submitted from legal experts in those jurisdictions.

When determining the classes of creditors or members for the purpose of requesting the convening of relevant meetings, the court will apply the test of whether, in relation to any given group of creditors or members, their rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest. Where the rights are not so dissimilar, creditors or members should be placed in one class for the purpose of the scheme or plan meeting and voting, but where they are so dissimilar, they ought to be placed in separate classes. Determining the relevant classes requires an analysis of the rights which are to be varied or released under or in connection with the scheme or plan and any new rights (if any) which the scheme, plan or the related restructuring gives to those creditors whose rights are to be released or varied.

In order to give creditors an opportunity to appear at the convening hearing to contest the proposed constitution of classes for the scheme or plan, the company will usually send to all affected creditors and members a document referred to as the "practice statement letter", typically at least 14 days before the date proposed for the convening hearing. The practice statement letter will set out the proposed claims for the purpose of the scheme or plan and the reasons the company considers such classes to be appropriate, and will usually include a brief summary of the rights creditors or members have prior to the effectiveness of the scheme or plan and an analysis of how those rights will be impacted by the scheme or plan.

In order for the court to properly consider the question of jurisdiction and appropriate class constitution, it will need sufficient detail on the existing rights of creditors, and/or members and how these rights will be impacted by the scheme/plan and related restructuring. For this purpose, the company will draft the scheme or plan document and an accompanying explanatory statement (which is often a very lengthy document). The explanatory statement must explain the effect of what is proposed by the scheme or plan in language that enables creditors and/or members to exercise their judgement as to whether the proposed scheme or plan is in their interest. The courts have stressed the importance of full and frank disclosure being made by the company both to the court and to creditors/members by way of the documentation.

If the court accepts jurisdiction in relation to the scheme or plan and agrees with the proposed class constitution then it will make an order authorising the company to convene the relevant meetings and ordering that the documents be provided to the creditors/members (in addition to a number of ancillary orders).

Once the documents have been made available to affected creditors/members, there will usually be a period of around 21 days for the creditors/members to consider the proposed scheme or plan before the scheme or plan meetings are held.

Scheme/plan meetings

Once the affected creditors/members have had a chance to consider the proposals, they are invited to attend the meetings to formally vote on whether they accept or reject the proposal. Attendance at the meetings can either be in person (where the relevant creditor/member is an individual) or by proxy, where individuals or companies can appoint an individual to vote on their behalf. It has also become common for the creditor/member meetings to be held virtually, rather than in person, and it remains to be seen whether this continues once the Covid-19 pandemic and related social distancing measures come to an end. In practice, many creditors will appoint the chairman of the meeting as a proxy and instruct the chairman to exercise their vote to either accept or reject the proposal. Once the votes have been cast, the votes for and against the proposal must be calculated. For a scheme of arrangement, the proposals will be approved if a majority in number (ie more than 50%) representing at least 75% in value of each class of creditors/members present and voting (in person or by proxy), has voted in favour of the scheme.

The voting and approval of the proposal in a restructuring plan works a little differently and a restructuring plan can either be consensual (meaning each class of creditors and/or members has approved the proposal as a class) or can be approved as a "cram-down" plan. A consensual plan will be approved where creditors/members representing at least 75% in value of each class of creditors/members present and voting (in person or by proxy), has voted in favour of the plan. If one class (the dissenting class) does not meet this 75% by value threshold, the restructuring plan may still be sanctioned if the criteria for a "cram-down" plan are satisfied, being:

– the court must be satisfied that, if the plan is sanctioned, none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative; and

– the plan must have been agreed by a number representing 75% in value of a class of creditors or (as the case may be) members, present and voting (in person or by proxy), who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative.

In this context, the relevant alternative is whatever is most likely to happen to the debtor in the absence of the scheme or plan – this is often an insolvent administration or liquidation where assets are realised and distributed to creditors.

If the relevant voting thresholds and conditions have been reached then the company may apply to the court for final approval of the scheme or plan at a hearing known as the "sanction hearing".

Sanction hearing

The sanction hearing will usually take place a few days after the meetings have been held. In connection with the sanction hearing, the court will consider whether the required statutory majorities of creditors/members voting in favour of the proposal have been reached and, in a “cram-down” plan whether the two criteria have been met and, in either case, whether it should exercise its discretion to sanction the scheme or plan.

The court will consider a number of factors when determining whether to exercise its discretion but these are likely to include: (i) whether the statutory requirements have been met; (ii) whether those creditors voting in favour of the scheme/plan were fairly representative of their class and were acting in good faith and not coercing the minority in order to promote interests adverse to those of the class to which they belong (ie that they were not voting for an ancillary purpose unique to them); (iii) that an intelligent and honest person who is a member of the relevant class and is acting in respect of his own interest might reasonably approve the scheme or plan (ie that the terms of the scheme or plan are “fair”); and (iv) that there is no “blot” on the scheme or plan.

The effect of these considerations is that the court may ignore or disregard votes in favour of the scheme or plan if it considers that the votes have been cast by creditors/members who have a special interest in promoting the scheme or plan and are not representative of the class as a whole. This may lead to votes being disregarded where a creditor is also interested in the company in its capacity as a shareholder or affiliated company or where it has received a special inducement, such as a fee, to vote in favour of the scheme or plan where such inducement was not available to other members of the class.

Effect of the scheme or plan

Having considered all relevant factors, if the court decides to exercise its discretion to sanction the scheme or plan and makes the appropriate order (and the order is registered (where appropriate) with Companies House or published in the Gazette), then the scheme or plan will become binding on all the creditors/members affected by it, including those who voted against, did not vote at all and even those who did not receive notice of the scheme or plan.

Company voluntary arrangements (CVAs)

A CVA under the Insolvency Act 1986 enables a company to reach an arrangement with its creditors under the supervision of an insolvency practitioner. In that sense, it is the closest we have to a debtor in-possession procedure. It is very different from a scheme of arrangement or restructuring plan in that the implementation requires practically no court involvement – merely filing requirements – and should therefore be a cheaper option to put into effect compared to a scheme of arrangement or restructuring plan.

The CVA procedure is essentially a contract between a company and its creditors whereby they agree how the company's debts should be dealt with. The procedure is very flexible and there are very few constraints on the form and content of the arrangement.

Prior to June 2020, a CVA had a distinct advantage over a scheme of arrangement and a restructuring plan for "small companies" (as defined in the Companies Act 2006) because such companies could make use of the CVA moratorium to limit creditor action. This advantage was nullified with the introduction of Part A1 of the Insolvency Act 1986 which provides for a standalone moratorium available to companies (for more information on the newly introduced standalone moratorium, please refer to the **"England and Wales – Moratorium" factsheet available here**).

In order to propose a CVA, a company must be either: (i) registered in England, Wales or Scotland; (ii) incorporated in an EEA state other than the UK; or (iii) incorporated outside of the EEA but with its centre of main interests in a member state other than Denmark.

Unlike schemes of arrangement or restructuring plans, the CVA procedure is one of the UK procedures listed in Annex A to the EU Insolvency Regulation 2015 (Regulation 2015/848) (the **Recast Regulation**) and is, therefore, available as both a main insolvency proceeding and a secondary insolvency proceeding. Under the Recast Regulation, until the end of the Brexit implementation period, the ability to commence a CVA in respect of a company incorporated in a member state other than the UK will be limited to those entities with their centre of main interests, or an establishment, in the UK.

Procedure

Proposal. The terms of the CVA are set out in the proposal. The proposal is made by the directors or, if the company is in administration or liquidation, by the administrators or liquidators. The exact terms of the proposal will, as with a scheme and plan, vary from case to case. Certain information must be set out in the CVA proposal as a matter of law. Any proposal must allow for the payment of any preferential debts in priority to unsecured creditors. The rights of a secured creditor to enforce its security cannot be affected without its consent. The rights of landlords to forfeit their property on the occurrence of an insolvency-related event (if applicable) may not be altered by the CVA proposal because a CVA can only impact on the rights of counterparties in their capacity as creditors and not any proprietary rights.[4] As with a scheme and a plan, where a CVA is proposed within 12 weeks of the end of the statutory moratorium, it cannot compromise moratorium debts (ie debts incurred during the moratorium under arrangements entered into during the moratorium) or priority pre-moratorium debts (ie the monitor's remuneration or expenses, goods or services supplied during the moratorium, rent for a moratorium period, wages or salary and certain redundancy payments etc). Subject to this protection afforded to secured and preferential creditors and landlords/ other proprietary rights, there is no restriction on the arrangements which a CVA proposal may make.

Nominee's report. The proposal should identify a person to act as nominee in relation to the CVA for the purpose of supervising its implementation; such nominee must be an insolvency practitioner. The nominee is required to submit a report to the court stating why or why not the proposal has a reasonable prospect of being approved and implemented and why the members and creditors should or should not be invited to consider the proposal. To enable the nominee to prepare this report, those making the proposal must give the nominee a statement of the company's affairs. Where the nominee is the administrator or liquidator, the nominee may summon a meeting of members and seek a decision of the creditors without the prior need to report to the court.

Once the initial steps have been taken, the nominee will call the meeting of members and will seek the approval of creditors using one of the decision procedures set out in the Insolvency (England & Wales) Rules 2016. The proposal must be approved by at least 75% by value of the creditors who respond in the relevant decision procedure, which must include more than 50% of the company's unconnected creditors. Votes are calculated according to the amount of the creditor's debt. Special rules apply to creditors with claims for an unliquidated amount or where the value is not ascertained. Although the CVA is a contractual arrangement between a company and its creditors, the approval of more than 50% by value of the company's members who are present and vote at a members' meeting is also required. In both cases, the majorities are calculated on the basis of those actually voting on the proposal. If the proposal is approved by the creditors but not by the members, then the decision of the creditors prevails, but the members have a right to challenge the decision on application to the court within 28 days.

[4] *Discovery (Northampton) Ltd v Debenhams* Retail Ltd [2019] EWHC 2303 (Ch).

Effect of a CVA

Implementation of a CVA does not require a court order. If the proposal is approved by the creditors, then all creditors who were entitled to vote in the decision procedure, or would have been entitled to vote if they had received notice of the decision procedure, will be bound by it, subject to creditors having the right to challenge the CVA for unfair prejudice or material irregularity. Challenges should normally be brought within 28 days.

During implementation of the CVA terms, the directors will remain in control of the company although the supervisor (usually the former nominee) will have an ongoing monitoring role, as set out in the CVA.

The CVA will come to an end when its terms have been complied with (or if it fails) and/or when the CVA provides that it should end.

Scheme, plan or CVA?

The decision as to whether it is better to use a CVA, a scheme of arrangement or a restructuring plan will depend on the facts and circumstances of each case.

All of these procedures can be used in conjunction with the statutory moratorium and so CVAs have lost the historic advantage they used to have in this respect.

All bind all creditors, except that a CVA cannot affect the rights of secured creditors without their consent (so no cram-down of secured creditors) nor can it affect the priority of preferential creditors vis-à-vis all other debts and their right to rank equally with each other; but a scheme/plan may give rise to class issues which it might be possible to avoid in a CVA. In this respect, a plan has a benefit over a scheme because of the ability to affect the cross-class cram down against a dissenting class. A scheme and a plan can affect members' as well as creditors' rights, but voting issues are generally more complex in a scheme particularly given the requirement for more than 50% by number of each class to approve the scheme. A scheme and a plan are generally more time-consuming and, consequently, more expensive to put together than a CVA. The court's approval is required. One advantage of the upfront court approval for a scheme or plan is that challenges are usually dealt with at an early stage, whereas the lack of court involvement in a CVA means that challenges will be dealt with separately and after the proposal is approved. A restructuring plan and a CVA will trigger the operation of the ban on *ipso facto* clauses[5] meaning that suppliers of goods and services cannot terminate or amend their contracts or do any other thing on the basis that the procedure has been launched, the same protection does not arise in relation to a scheme of arrangement.

For so long as the Recast Regulation continues to have effect in the United Kingdom (likely until 31 December 2020), if recognition of the process will be required in the EU, a CVA may be more appropriate as EU member states are required to give automatic recognition to a CVA implemented in the UK. Neither a scheme of arrangement nor a restructuring plan is subject to the same automatic recognition process under the Recast Regulation but recognition may be achieved under the Recast Regulation if the scheme or plan is conducted under the umbrella of administration. Recognition of a scheme or plan can also be sought and obtained from the court of each jurisdiction concerned (the fact that a scheme or plan is likely to be recognised may be sufficient without the need to actually formally obtain recognition). It remains to be seen how Brexit may impact cross-border insolvencies and restructurings and will depend upon the agreement reached between the EU and the UK on their future relationship. For more information on this please refer to our **Brexit Paper**.

If the company has assets in the U.S., recognition of the proceedings could be sought in the U.S. to protect those assets from creditor action. All of CVAs, schemes of arrangement and restructuring plans are capable of recognition in the U.S. (under Chapter 15 of the US Bankruptcy Code), although if U.S. securities are involved, consideration may also need to be given to the US Securities Act of 1933, which may impact on whether a scheme, plan or a CVA is more appropriate.

[5] Both a convening order being made by the court in respect of a restructuring plan and/or a CVA taking effect in relation to the debtor company triggers the ban on the operation of *ipso facto* clauses contained in section 233B of the Insolvency Act 1986. More detail on this can be found in the "England and Wales – Overview" factsheet available here.

Key contacts

If you require advice on any of the matters raised in this document, please call any of our partners or your usual contact at Allen & Overy.

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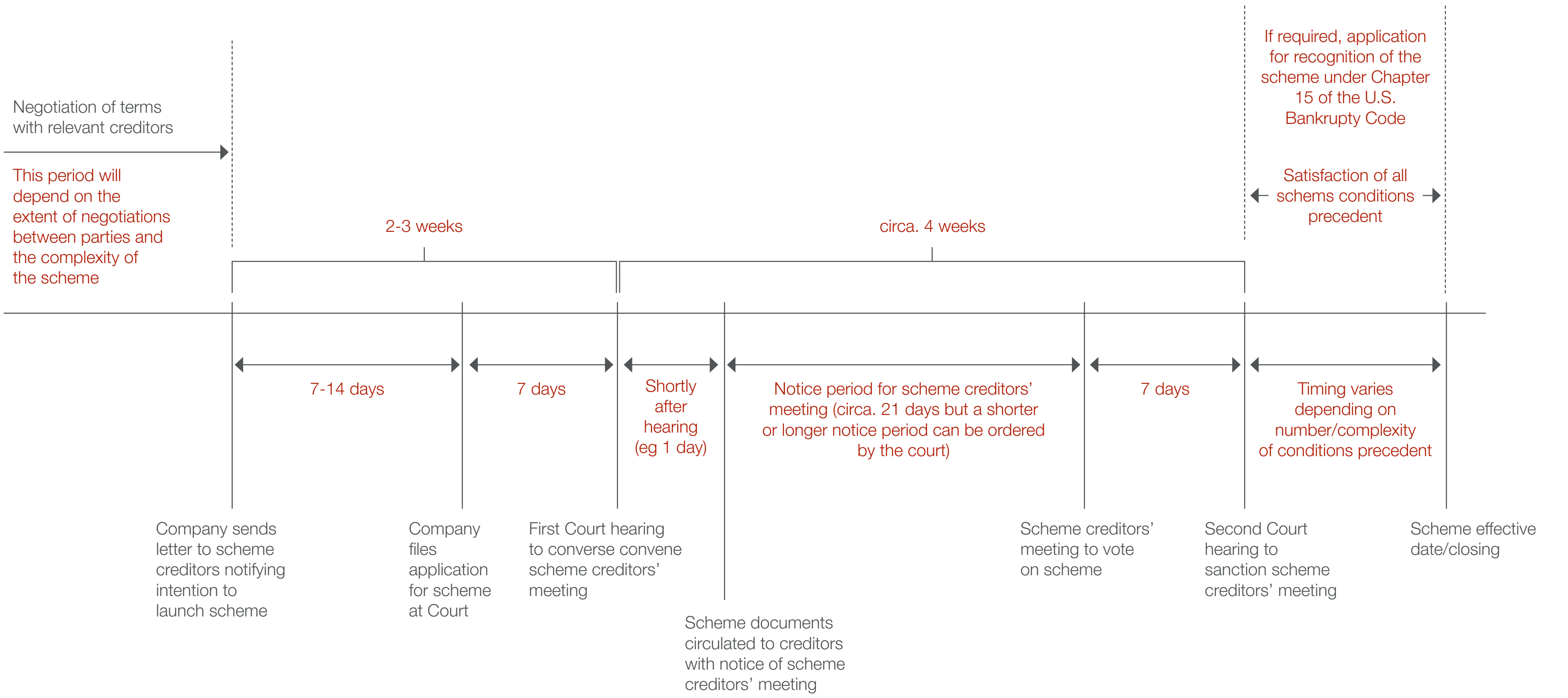
Appendix 1: Indicative timetable for key steps in a scheme of arrangement



Further information

Developed by Allen & Overy's market-leading Restructuring group, "Restructuring Across Borders" is an easy-to-use website that provides information and guidance on all key practical aspects of restructuring and insolvency in Europe, the Middle East, Asia and the U.S. To request access for your organisation, please contact your usual Allen & Overy contact.

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