Lock ups, vote splits and matters of jurisdiction:

further developments in relation to schemes of arrangement

Joe Bannister examines instances of conflicting grounds for jurisdiction and creditor/shareholder support of English schemes.

The Companies Act scheme of arrangement – now set out in part 26 of the Companies Act 2006 (CA 2006), has come a long way. Long gone are the times when schemes of arrangement – never an Insolvency Act process – were merely seen as tools for implementing solvent reorganisations. Schemes of arrangement are nowadays one of the most favoured means for rescheduling, reorganising or otherwise compromising the liability of companies to their creditors in complex multi-jurisdictional restructurings.

English schemes are popular because of the breadth and flexibility of the legislative provisions and their low jurisdictional threshold. Additionally, the courts take a robust and pragmatic approach to the proponents and opponents of the part 26 process. This article summarises four examples of that pragmatism in action.

Conflicting grounds for jurisdiction

English courts have taken jurisdiction for considering part 26 schemes on differing grounds. Two cases illustrating that difference are *Re DTEK Finance PLC* [2016] EWHC 3563 (*DTEK*) and *Re Global Garden Products Italy SpA* [2016] EWHC 1884 (*GGP*). The former is a decision of Norris J while the latter is a ruling of Snowden J. *DTEK* involved a company incorporated in England and Wales whereas the subject company in *GGP* was incorporated in Italy.

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In *GGP*, Snowden J repeated the well-established principle that the English courts may sanction a scheme in relation to any company that is liable to be wound-up under the Insolvency Act 1986 (IA 1986). Snowden J went on to repeat the well-established rule that the 'liable to be wound-up' threshold the courts apply extends to a company incorporated outside England and Wales. There are two principal matters to be shown. The first is that there is a reasonable possibility of creditors benefitting from the scheme process. Additionally, the court must be satisfied that one or more persons interested in the distribution of the company's assets are persons over whom the English courts can exercise jurisdiction. Snowden J found these requirements were satisfied in *GGP*. In *DTEK*, this test was inapplicable given *DTEK's* incorporation in England.

More contentious is the basis upon which the courts claim jurisdiction over scheme creditors. This is particularly so for schemes in respect of European companies. The European Insolvency Regulation is inapplicable to schemes. However, it is unclear whether chapter II of the recast EU Judgments Regulation (No. 1215/2012) applies to schemes of arrangement. In order to avoid determining this question, the courts have, on a number of occasions, assumed that the recast regulation applies. It governs 'civil and commercial matters'. It is also » inapplicable to bankruptcy or winding-up proceedings. The courts have generally accepted that part 26 schemes are *prima facie* 'civil and commercial matters' under the recast regulation.

Home is where your court is

Article 8 of the recast regulation provides that a person – including a company – domiciled in a member state can also be sued in the courts where any one of a number of defendants is domiciled. The courts' approach is to treat the part 26 scheme as a claim brought against a number of defendants. Hence the courts will take jurisdiction to sanction a scheme where any one scheme creditor is domiciled in England and Wales, and the court is satisfied that claims of the scheme creditors are 'so closely connected that it is expedient to hear and determine them together'.

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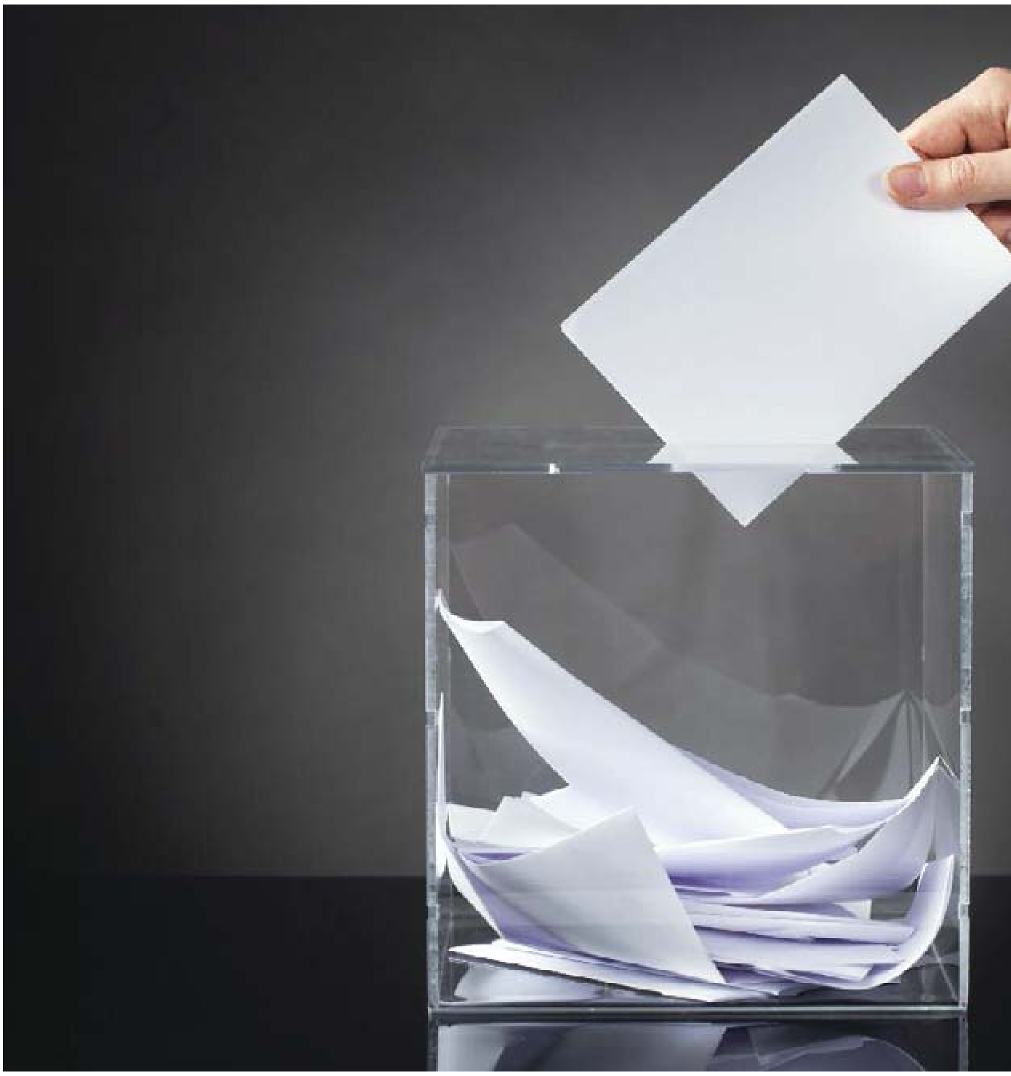

This 'expediency' test has been most controversial. In *DTEK*, Norris J identified two grounds to satisfy it. The first is the desirability of binding all scheme creditors into the same restructuring. The alternative depends upon satisfying the court that there are sufficient creditors in number and value domiciled in the United Kingdom to make the exercise of jurisdiction appropriate.

Norris J declared himself (paragraph 21 of *DTEK*) 'firmly' in favour of the first alternative. Hence he saw it as unnecessary to assess the number and value of creditors domiciled in the United Kingdom as a ground for jurisdiction.

In *GGP*, Snowden J reached the opposite conclusion. He insisted on more specific evidence than hearing scheme creditors holding at least 28.37 per cent of scheme claims by value were domiciled in the United Kingdom. Snowden J only agreed to move forward on receipt of evidence that three of the five creditors referred to were major financial institutions incorporated in the United Kingdom holding between them a little more than 24 per cent of scheme claims. He also drew comfort from hearing that the other two creditors were funds managed by Alcentra Limited and Halcyon Loan Advisors Limited, both of which were companies incorporated in the United Kingdom. Based on that evidence, Snowden J concluded that if the recast regulation did apply, article 8 gave him jurisdiction on the basis that sufficient creditors by number and value were domiciled in the United Kingdom.

Both Snowden J and Norris J agreed that the 'sufficient connection' test referred to above could only be satisfied by evidence that there was sufficient prospect of a scheme being recognised in other jurisdictions where the company operated. In *GGP*, Snowden J received expert evidence that the scheme would be recognised in Italy. In *DTEK*, Norris J sanctioned the scheme on the basis of evidence that it would be recognised in New York as the jurisdiction of a number of the company's creditors.

'Lock up' or 'thumbs up?'

Two recent cases have readdressed the two principal means whereby creditors – or shareholders – may support schemes. The first is where creditors – or shareholders – give irrevocable undertakings either to vote in favour of a scheme or to provide written consent to the scheme's terms and implementation. *Re SABMiller PLC* [2016] EWHC 2153 (*SAB*) addressed these questions. Although Snowden J was dealing with a shareholder scheme put forward to enable the takeover of SAB by AB InBev, the scheme proponents – and Snowden J – followed the same rules applicable to creditor schemes. *SAB* is therefore equally relevant to the current round of creditor schemes.

In *SAB*, the two largest shareholders had given irrevocable undertakings either to vote in favour of the scheme or to consent in writing to its implementation. Certain other shareholders, while intending to support the scheme, opposed the company's intention of excluding these two large shareholders from the scheme meetings. Snowden J rejected the shareholders' application. He held that the purpose of a part 26 scheme was to facilitate compromises and to supply a statutory alternative to agreements between a company and its members or creditors. That compromise would allow the prescribed majorities to bind dissentient or absent majorities.

Snowden J went on to say that to make the legislation effective, the courts had to adopt a flexible and purposive approach to part 26 schemes. Snowden J acknowledged (paragraph 30) the risks of excessive sub-division of creditor classes. He identified the principal risks as being that of conferring veto rights on small minority groups. Snowden J went on to say that part

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26 did not prevent creditors from voluntarily agreeing to waive or forego their rights to participate in scheme meetings. There was no difference between this and the position of a member or creditor of a company simply deciding against attending and voting at the creditors' meeting.

Snowden J, laid weight upon the fact that neither shareholder was acting under compulsion. He also recognised that the proposed scheme would not operate to confiscate or expropriate the shareholder's rights. There was in consequence no 'legal or practical necessity' to construe part 26 as preventing creditors or shareholders from deciding against taking part in scheme meetings.

In *GGP*, Snowden J also considered 'lock up' agreements. In the *GGP* scheme, the holding company (Topco), two other companies and two credit support providers, Alcentra Limited and Halcyon Structured Asset Management European CLO 2006-11BV (the coordinators) concluded a 'lock up' agreement. Under that agreement, the coordinators agreed to vote in favour of the scheme. That agreement was circulated to other scheme creditors. They were told that if they signed the lock up by a specified date, they would receive payment of a fee of 0.5 per cent of their locked up credit support commitment or claim.

Snowden J held that those creditors who signed up to the lock up arrangement and received a fee could go in the same class as other scheme creditors. Once again, Snowden J focused upon part 26's purpose in facilitating compromises. He pointed out that the 'lock up' arrangements were available to all scheme creditors. He also recognised that the fees were a relatively small amount when compared with the liabilities to be compromised.

Vote splitting

A part 26 scheme can only proceed if it is approved by a *majority in number* representing *three quarters in value* of the creditors or class of creditor voting in favour of the scheme. In *Re Dee Valley Group* [2017] EWHC 184 (Dee Valley), the English court looked for the first time at the numerosity (majority in value) aspect of the part 26 process. In particular, the court had to consider whether to sanction a scheme where shares had been transferred to sufficient additional shareholders to ensure that the numerosity test was not met. Once again, the *Dee Valley* ruling, although made in a shareholder scheme, could also apply in a creditor scheme.

The key facts in *Dee Valley* were that after publication of scheme documents, one shareholder transferred 443 of his shares to 443 individual shareholders. The purpose was to ensure that the scheme was voted down by a majority in number of the shareholders – in effect employees who opposed the scheme.

Having become aware of these share movements, the company applied to the registrar for a direction that the chair of the shareholders' meeting should be allowed to reject the votes of the new shareholders. The direction was given and the votes were duly rejected. The result was that the scheme was approved. At the sanction hearing, the judge had to consider whether the scheme should proceed.

The judge held that the scheme should indeed be sanctioned. He emphasised that the court responsible for a part 26 scheme had inherent power to direct the way in which meetings were to be held. Provided the chairman did not act perversely or in bad faith, it was unnecessary for him to have a court direction in order to have the power to reject votes.

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In the judge's view, the fact the chairman knew of the circumstances in which individual shareholders acquired their shares gave him the evidence necessary to conclude that the votes were not being cast for the purpose of benefitting the class as a whole. This was because, on the evidence, the only possible explanation for the individual shareholders' conduct was the implementation of a share manipulation strategy to defeat the scheme.

As stated above, *Dee Valley* is equally applicable to creditor schemes. This is because the two-tier test applicable under part 26 is open to manipulation and has been criticised on this basis. In that respect, the value of the numerosity test is open to question. Nevertheless, *Dee Valley* at least illustrates the courts' willingness to look critically at its application where significant movements occur in response to the proposal of a scheme of arrangement. □

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