Forging the connection: Foreign companies & English schemes of arrangement

James Watson reports on recent developments in this ever-evolving area

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For a process enshrined in a few brief sections of the English Companies Acts, the meteoric rise in recent years of the scheme of arrangement to become one of the world's most renowned debt restructuring tools is quite a story.

A scheme allows a statutory majority of creditors (comprising a majority in number and 75% by value of those voting in each class) to vary the rights of the entire class and to "cram down" any dissentients, subject to the oversight of the court. In financial restructurings, schemes are typically used to make fundamental changes to the debt documents and/or capital structure that would otherwise contractually require the consent of a super-majority of all lenders (including extending maturity dates, writing off or capitalising debt and releasing security).

Having become a staple in UK deals, schemes have also increasingly been used to restructure the debts of foreign borrowers. In some cases, there has been no analogous process in the borrower's home jurisdiction that would allow it to implement a viable restructuring, while some borrowers have simply decided there are benefits in using a UK scheme over a local process.

Recent developments suggest the trend is set to continue, albeit subject to certain caveats.

When can a foreign company use an English scheme?

The English court will only accept jurisdiction to sanction a scheme of arrangement in respect of a foreign-incorporated company if it is satisfied that there is a "sufficient connection" with England.

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It is now well established that a company will have such a "sufficient connection" if:

- it has substantial assets in England;
- its centre of main interests (COMI) is in England; or
- the liabilities subject to the scheme are governed by English law (whether or not coupled with an English jurisdiction clause).

English judges have grappled with whether their jurisdiction is limited by the Judgments Regulation but, to date, satisfied themselves in each case that it is not an issue on the facts (though this is a complicated point which has not, to date, been definitively resolved).

The court will also only sanction a scheme if the debtor can show it is likely to be recognised in the jurisdiction in which the company is incorporated and any other relevant jurisdictions. Market practice is for the company to obtain, and produce to the court, independent expert evidence from foreign counsel to this effect.

What about a foreign company without an existing connection to England?

Even if a distressed borrower initially has no connection whatsoever to England, recent cases have highlighted two ways in which one may be created, and accepted by the English court, for the purposes of pursuing a scheme.

(i) COMI-shift

One option is to move the COMI of some or all of the obligors to England. This technique has been used in many restructurings including, recently, the *Magyar Telecom*, *New World Resources* and *VGG* transactions.

The court will need to be satisfied that COMI has moved to England by reference to factors that are objective and ascertainable by third parties. Typical steps include moving the group's head office, principal operating address, books and records, day-to-day administrative activities and tax residency to England, holding board meetings in England and appointing UK-resident directors, and notifying all creditors and interested parties.

Though the EC Regulation on Insolvency Proceedings (in its present form and recast) contains no prescribed "look-back" period in assessing COMI, companies will need to take the steps in good time before the first scheme hearing.

(ii) Amend governing law / jurisdiction clauses

Another option is to amend the governing law clause in the company's (foreign law) debt documents to English law. This will depend on whether the documents can be contractually amended with less than 100% lender consent.

This approach came to prominence in the *Apcoa* scheme last year, where German governing law and jurisdiction clauses were amended with the consent of at least 66.66% by value of the lenders for the purposes of pursuing a scheme. Though a dissentient lender challenged whether this could constitute a sufficient connection, the court ultimately sanctioned the scheme.

The judge concluded that it did not matter in principle whether the debt documents were originally governed by English law, or subsequently amended to provide for this, as long as the amendment was effective as a matter of local law. He warned that the court should be wary if the new choice of law "*appears entirely alien to the parties' previous arrangements and/or with which the parties had no previous connection*", has no discernible purpose other than to favour the majority at the expense of the dissentients or is otherwise a "*step too far*". However, a number of factors persuaded him that this was not the case, including the fact that creditors had been told expressly that the purpose of changing the governing law was to pursue an English scheme.

(iii) "Belt-and-braces" approach

The more recent DTEK scheme (like the Mobile-8 scheme some years before) combined both a COMI-shift to England and an amendment to the governing law of the company's New York law bonds, establishing separate bases for a sufficient connection.

However, it is notable that the court followed *Apcoa* and confirmed that the change of governing law alone sufficed. Further, the judge swiftly concluded that English law was not alien to the arrangement, given that it is commonly used in debt obligations in the capital markets.

The future: opportunities and limitations

The *Apcoa* and *DTEK* schemes are undoubtedly significant milestones in the continuing expansion of the English courts' scheme jurisdiction.

However, their impact in the European loan market may be tempered by the fact that, since 2012, the Loan Market Association has recommended in its leveraged finance standard loan documentation that an amendment to governing law should require all-lender consent. There may therefore be only limited numbers of loans in the coming years that open the door for a scheme through a governing law amendment.

Given the increasing prevalence of bond financing in recent years, the decisions may have a greater impact in this market. However, an amendment to governing law alone will not suffice if recognition of the scheme and associated relief under Chapter 15 of the Bankruptcy Code are required (as it may well be in cases involving bonds governed by New York law); if so, the debtor will need to have its COMI, or at least an establishment, in England. But given that a COMI-shift to England will establish a sufficient

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connection in itself, will amending the governing law be much more than a secondary issue (added as a *belt-and-braces* measure to add greater certainty that the English court will accept jurisdiction)?

More generally, COMI-shifting is tried and tested and seems likely to remain the main focus for foreign borrowers wishing to establish a sufficient connection with England. However, while it may be straightforward to take the necessary steps when dealing with a holding or finance company borrower, this may not be viable for an operating company. There may also be situations where there are other obstacles to moving COMI or establishing with sufficient certainty that this has been achieved.

Creativity amongst legal advisers (coupled with a commercial and pragmatic approach by the court) has underpinned the expansion of the English scheme jurisdiction, and it is possible that other, novel ways will be found to forge a connection. For example, in the recent *AI Scheme Limited* decision, the court blessed a structure involving the voluntary assumption of liabilities by a special purpose orphan vehicle for the purposes of pursuing a scheme that released claims against the original debtors. This was in a domestic context involving consumer creditors, and the court cautioned that any such structure would need a "*solid grounding in commercial necessity*", but it raises interesting questions as to its potential application in the context of a cross-border financial restructuring.

As a closing remark, it should be noted again that some foreign borrowers have historically used English schemes due to the absence of equivalent local law processes. Several European jurisdictions have sought to address this in recent years by modernising their legislation to embrace out-of-court restructuring tools. In time, this may stem the tide of borrowers coming to England. However, for now, the versatility and track record of the English scheme and the consistency of the English courts means England remains an attractive destination for implementing a financial restructuring. ■

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