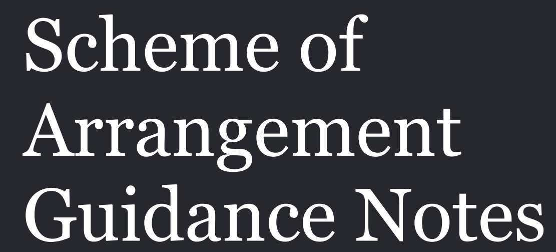


**August 2022**

Cork Gully

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# Scheme of Arrangement Guidance Notes

# Scheme of Arrangement Guidance Notes

## What is a Scheme of Arrangement?

- A Scheme is a compromise or arrangement between a company and its creditors (or any class of them) and/or its members (or any class of them).
- While a Scheme can be used for company takeovers, this is not considered in this guide, which focuses on the application of Schemes for insolvent entities.
- A Scheme is not an insolvency procedure carried out under the Insolvency Act, but is carried out under Part 26 of the Companies Act.
- A company successfully fulfilling its obligations under an approved Scheme, and restructuring its debt obligations, by either compromise or arrangement, can continue as a solvent entity.
- A Scheme can be proposed by:
  - A company
  - Administrator
  - Liquidator
  - Creditors
  - Members
- Typically, it is the company that proposes a Scheme, although an Administrator or Liquidator already in office may propose a Scheme to provide a mechanism for a company to exit insolvency. Given their complexity, creditor or member proposed Schemes are rare.

## Scheme Procedure

**Step 1: Consider viability**

- A Scheme to restructure the debts of an insolvent entity will typically involve creditors, in return for waiving some or all of their rights, receiving:
  - A share in the future profits of the restructured business;
  - Defined rights over the distribution of assets to creditors with varying rights; or
  - Ownership rights over the restructured business – a debt for equity swap – either by way of:
  - Ownership rights over the company proposing the Scheme
  - Ownership of a new company into which the Scheme company is transferring assets
  - By their approval of the proposed Scheme, creditors approve how those assets are dealt with in respect of their interest in them.
- With the exception of a Scheme being used to define rights to assets in a distribution (which is typically used by companies in Liquidation or Administration), in order for creditors to support the proposals, they must believe that it will provide them with a better return than the alternative – which is likely to be Administration or Liquidation
- The returns offered under it must be both attractive and achievable. If the restructured business cannot support creditors' expectations, it will not be a suitable method of seeking a compromise.
- Demonstrating this case is central to the viability of the scheme proposed and securing the necessary creditor support and the scheme's viability.

**Step 2: Consider creditor pressure**

— Although it may be that the Court will dismiss or adjourn the hearing of a winding up petition for the company proposing a Scheme, there are no formal moratorium arrangements that protect company formulating a Scheme from its creditors.
— Creditors can continue to levy execution or can distrain over the company's assets when they are entitled to do so – potentially interfering with operations and jeopardising the viability of the Scheme.
— Consequently, a Scheme is very likely to have to be a consensual process, with debts of the company paid as they fall due prior to the Scheme being put to creditors.
— The Corporate Insolvency and Governance Act 2020 ("CIGA 2020") has, however, introduced a new moratorium which whilst not connected with any insolvency procedure does provide eligible companies with protection from its creditors which can be used by a company while formulating a Scheme. Please see additional Guidance Notes.
— Alternatively, the directors could place the company into Administration first, in order to gain the protection of the moratorium that are afforded to Administrations. A Scheme could then be proposed as an exit to Administration, if the Administrator felt that course of action was suitable. Please see additional Guidance Notes.

**Step 3: Appoint advisers and draft the Scheme documents**

— Due to the complexity of the process of formulating a Scheme and the need to make court applications and convene creditors meetings for its approval the company will need to need to appoint legal and financial advisers.
— The financial advisers will typically be a firm of Insolvency Practitioners; once the Scheme is approved, members of that firm will then become the Scheme Supervisor or Scheme Administrator (the terms are interchangeable) and administer the terms of the Scheme for its duration.
— One of the key tasks for a company's advisers will be to draft the Explanatory Statement required by s897 of the Companies Act to be sent to affected creditors. This will set out the terms of the Scheme and will need to demonstrate:
  — Why, in the directors' opinion, the Scheme should be supported by creditors and why they are, therefore, recommending it;
  — A comparative estimated outcome statement, indicating the outcome that affected creditors will receive under the Scheme and the likely outcome in Administration or Liquidation;
  — The business, its history, how it will be run to support the Scheme, and its anticipated performance;
  — The assets of the company that will be available to creditors and the distributions creditors are likely receive under the Scheme;
  — The identity of the Scheme Supervisors, their powers and functions, and their remuneration; and
  — Any guarantees given by third parties, or third-party funds extended, to the company to support the Scheme.
— The Scheme itself, which will form part of the Court submission, will also need to be drafted, as will any necessary supporting witness statements, and the form of proxy and proof of debt form to be sent to creditors.

**Step 4: Determine Creditor Classes**

— A key step in preparing a Scheme proposal to be put to creditors is determining the creditor classes that the company has.
— The grouping of creditors into classes has important implications and is one of the areas of greatest contention and possible challenge. In contrast to a CVA, where all unsecured creditors vote on its approval, approval of the Scheme is required from each class of creditors with a continuing economic interest in a company's assets i.e. who would be entitled to a share of the company's assets were that company to be wound up, and who will be affected by the proposed Scheme ("Scheme Creditors").
— Creditors in classes that are either unaffected by a Scheme (as they are not being compromised because they will be repaid in full) or who do not have a continuing economic interest in the company (as their rights as creditors do not rank sufficiently highly in the order of repayment in an Administration or Liquidation) do not get the chance to vote on the approval of the Scheme.
— Given its complexity, importance, and being one of the principal areas of challenge, detailed legal and insolvency advice should be sought in determining the creditor classes.
— Creditors are grouped into a class where their respective rights are similar - although these rights need not identical, rather, they should be "not so dissimilar as to make it impossible for them to consult together with a view to their common interest".
— Classes might be, for example, fixed charge creditors and/or floating charge creditors (typically banks), preferential creditors (typically HMRC and employees) and unsecured creditors (e.g. trade creditors, landlords etc.), although complex Schemes see many classes where varied rights are held.

- If the composition of the creditor classes is contentious the company should notify interested parties of the Convening Hearing.

**Step 5: Meeting of creditors & members**

- Under s896 of the Companies Act, a company has to seek the approval of the Court to call a meeting or meetings of Scheme Creditors – there being a separate meeting for each class of affected creditors. At this stage, the Court will consider whether the Scheme as presented is fair.
- Creditors can object at this stage – if, for example, they feel they have been unfairly disenfranchised, or they feel their creditor class should participate in the assets of the company under the Scheme.
- If the Court grants permission for the Scheme meetings to be called, an Explanatory Statement, setting out the terms of the Scheme will be sent to Scheme Creditors, along with notice of the Scheme Meeting, a proof of debt and proxy form.

**Step 6: Scheme Creditors' Meetings**

- The Scheme must be approved by a majority of Scheme Creditors, the creditors to whom the Scheme applies. Under s899 of the Companies Act, the required majority is:
- Scheme Creditors holding 75% of the value of claims present in person or by proxy and voting at the scheme meeting; and
- That also represent a simple majority (50%) in number of creditors present and voting at the scheme meeting.
- Different classes of creditors vote separately and the scheme must be approved by the required majority of each class of creditors at a separate Scheme meeting for each class.

**Step 7: Court Approval – the Sanctioning Hearing**

- s899 of the Companies Act then requires the company to apply to Court for its sanction of the Scheme.
- The Chairman of the Scheme meetings is required to report the results of those meetings to the Court in a formal report in order for the Court's sanction to be given. The Scheme can, again, be scrutinised at this stage.

**Step 8: The Scheme begins**

- s900 of the Companies Act requires that a copy of the Order granted by the Court to sanction the Scheme has to be delivered to the Registrar of Companies (Companies House). At this point, the Scheme becomes "Effective".
- Scheme Creditors then have a period of time (typically 3 months) to submit a proof of debt form in respect of their claim for a distribution under the rules of the approved Scheme.
- If they did not submit a form in time – by the "Bar Date" – their claim would be rejected. A Scheme Creditor with a claim accepted by the Scheme Supervisor under the rules of the approved Scheme can participate in the benefits he is assigned under the Scheme pro rata to other Scheme Creditors whose claims have been admitted.
- The Scheme will then continue in accordance with its terms until it completes and ends (or, if unsuccessful, terminates early). While reporting requirements may be incorporated into the Scheme, unlike a CVA there are no statutory periodic reporting requirements.

## Advantages of Scheme

- Although similar to CVA, in that a Scheme is, fundamentally, either a compromise or arrangement, a Scheme provides greater flexibility.
- A Scheme offers the additional scope of being used where a company is seeking to compromise the rights of its secured creditors (which cannot be compromised in a CVA, unless they all consent).
- A Scheme can also be more selective in its application than a CVA. For example, when the circumstances permit, a Scheme can be used to apply to a single class of creditors – where either only those creditors retain an economic interest in the company, or where all other classes would still be repaid in full.
- Schemes also provide a tool for dealing with dissenting creditors – who are typically "out of the money" – provided that their economic rights do not permit them to vote on the Scheme's approval, or that within their class of creditors they do not form a sufficiently large block to prevent the Scheme's approval.
- The consent of those creditors without an economic interest in the company is not required. This contrasts to a CVA where all creditors vote.

- Schemes can also be useful for companies who have neither their centre of main interest (COMI) in the UK, nor an economic establishment. A test of there being “sufficient connection” to England and Wales replaces the COMI test that would apply to Insolvency Act procedures, and this has been interpreted widely by the courts to allow, for example, foreign companies with debt issued under English Law, to undergo Schemes in preference to local procedures.
- Ultimately, as a Scheme is not an insolvency process, there is less stigma attached to it compared to either a CVA or any other Insolvency Act process. A company may therefore achieve its desired objective of compromise or arrangement with creditors, without impairing its goodwill.
- Furthermore, directors of a company that undertakes a Scheme and successfully agree a compromise or arrangement with its creditors are not subject to the reporting requirements under the Company Directors Disqualification Act 1986.

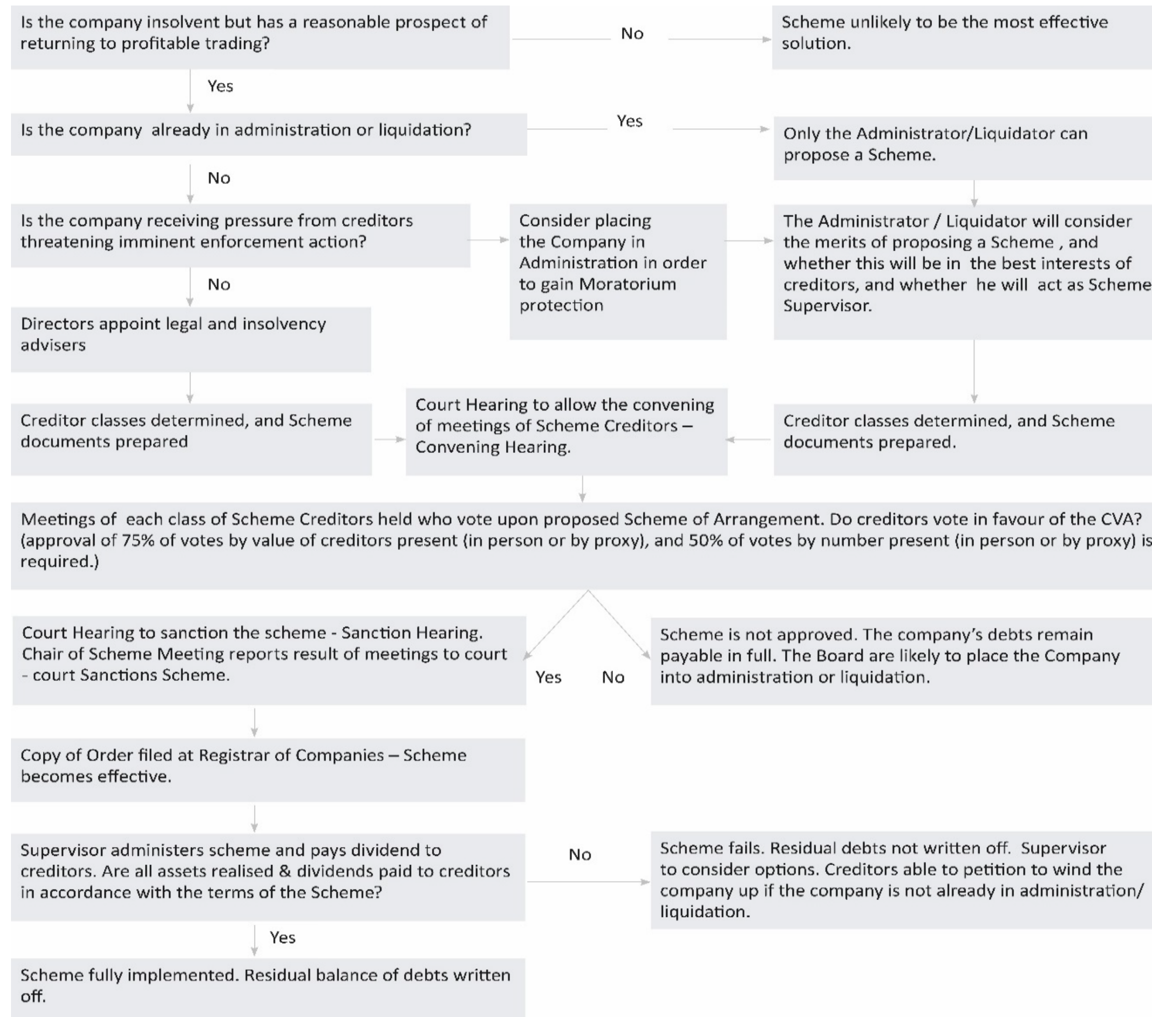
## Disadvantages of a Scheme

- If approved by the requisite majority of creditors, court approval is still required for the Scheme to go ahead (at the Sanctioning Hearing). Not only is this an additional requirement, the application involves additional costs.
- Given their complex nature – through the need to assess and deal with creditor classes separately and the additional court approval process – Schemes are typically more expensive than CVAs and have therefore historically been for larger restructurings.
- If creditors believe directors have been deficient in their duties, they may not support a Scheme, and instead favour Liquidation.
- Similarly, while a Scheme may be favoured by creditors willing to wait for return over a prolonged period, those favouring a quicker return may instead opt for a simpler and more straightforward Liquidation – unless there is a sufficient differential between likely returns to creditors under the two processes.

## Definitions

| | |
|---|---|
| Companies Act | Companies Act 2006 |
| CVA | Company Voluntary Arrangement |
| Insolvency Act | Insolvency Act 1986 (as amended) |
| HMRC | Her Majesty’s Revenue and Customs |
| Scheme | Scheme of Arrangement |
| COMI | Centre of Main Interest, as defined in the European Council Regulations (1346/2000/EC) on Insolvency Proceedings |

# Appendix 1: Scheme process flowchart



# Appendix 2: Summary Scheme timeline

| **Activity** | **Date** |
|---|---|
| Advertise application to court | > 1 week prior to hearing |
| 1st court hearing - “Convening Hearing” | “Hearing Date” |
| Notice of meeting sent to all scheme creditors, together with Explanatory Statement | 42 days prior to Scheme Creditors Meeting(s) |
| Creditors Meeting(s) | |
| 2nd court hearing “Sanctioning Hearing” | 21 days after Scheme Creditors Meeting |
| Scheme Effective Date | Day following the Sanctioning Hearing |
| Notice sent to all Scheme Creditors that Scheme is Effective | Within 14 days of Scheme Effective Date |
| Advertise Bar Date | At least 6 weeks before Bar Date |
| Scheme Bar Date | 90 days from Scheme Effective Date |

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