Based on a solid heritage we are an advisory firm bringing clarity to complex restructuring, recovery and insolvency situations.

The firm remains as committed to our founding principles today as we were a hundred years ago. Our partners and staff have worked together for over ten years, reorganising operations and structures to deliver sustainable stakeholder value. The current trading environment is increasingly complex, so the solutions we provide for our clients are more creative, more responsive and more effective than ever.
What is a Scheme of Arrangement?

- A Scheme of Arrangement 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.

Step 1: Consider viability

- A Scheme of Arrangement can be proposed by:
  - The 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 the Company to exit insolvency. Given their complexity, creditor or member proposed Schemes are rare.
- A Scheme of Arrangement 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 (e.g. Welcome Financial Services Limited);
  - Defined rights over the distribution of assets to creditors with varying rights (e.g. Enron Capital & Trade Resources Limited); or
  - Ownership rights over the restructured business – a debt for equity swap – either by way of:
    - Ownership rights over the company proposing the Scheme (e.g. Crest Nicholson), or
    - Ownership of a new company into which the Scheme company is transferring assets (e.g. IMO Car Wash)
- 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 a company proposing a Scheme of Arrangement, there are no formal moratorium arrangements that protect a company formulating a Scheme of Arrangement 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.
Scheme Procedure

- Alternatively, the directors could place the Company into administration first, in order to gain the protection of the moratorium that Administrations enjoy. A Scheme could then be proposed as an exit to Administration, if the Administrator felt that course was suitable. Please see the additional Cork Gully LLP Guide to Administration for further details of that process.

Step 3: Appoint advisers and draft the Scheme documents

- Due to the complexity of the process of formulating a Scheme of Arrangement 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 of Arrangement 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.

- 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 – or a pre-pack Administration, where no creditor approval is required - 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 a 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.

Step 4: Determine Creditor Classes

- A key step in preparing the Scheme of Arrangement proposal to be put to creditors is determining the creditor classes that the company has.

- The Scheme of Arrangement 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 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 – it, 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, and 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 of arrangement 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.
**Scheme Procedure**

- 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 of Arrangement.

- 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 a Scheme**

- Although similar to Company Voluntary Arrangement, 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 (or, alternatively, a pre-pack Administration where no creditors vote).

- Schemes can also be useful for companies who have neither their 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.

- As with CVAs, section 144 of the Finance Act 1994 allows for profits from the release of a company’s debts that take place within a Scheme to be exempt from Corporation Tax.
Disadvantages of a Scheme

• While the courts may reject a petition from a creditor for the winding up of a company while it is considering a Scheme, there is no moratorium protection available as would be the case for a small company preparing a CVA under Schedule A1 of the Insolvency Act.

• 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
- CVA
- Insolvency Act
- HMRC
- Scheme
- COMI

Companies Act
Company Voluntary Arrangement
Insolvency Act 1986 (as amended)
Her Majesty’s Revenue and Customs
Scheme of Arrangement
Centre of Main Interest, as defined in the European Council Regulations (1346/2000/EC) on Insolvency Proceedings
Appendix 1: Scheme process flowchart

Is the company insolvent but has a reasonable prospect of returning to profitable trading?  
No  
Yes  
Is the company already in administration or liquidation?  
Yes  
No  
Is the company receiving pressure from creditors threatening imminent enforcement action?  
No  
Yes  
Consider placing the Company in Administration in order to gain Moratorium protection  
Scheme unlikely to be the most effective solution.  
Only the Administrator/Liquidator can propose a Scheme.  
The Administrator / Liquidator will consider the merits of proposing a Scheme, and whether this will be in the best interests of creditors, and whether he will act as Scheme Supervisor.  
Meetings of each class of Scheme Creditors held who vote upon proposed Scheme of Arrangement. Do creditors vote in favour of the CVA? (approval of 75% of votes by value of creditors present (in person or by proxy), and 50% of votes by number present (in person or by proxy) is required.)  
No  
Yes  
Creditor classes determined, and Scheme documents prepared.  
Creditor classes determined, and Scheme documents prepared.  

Supervisor administers scheme and pays dividend to creditors. Are all assets realised & dividends paid to creditors in accordance with the terms of the Scheme?  
No  
Yes  
Scheme fails. Residual debts not written off. Supervisor to consider options. Creditors able to petition to wind the company up if the company is not already in administration/liquidation.  
Scheme fully implemented. Residual balance of debts written off.

Appendix 2: Summary Scheme timeline

<table>
<thead>
<tr>
<th>Activity</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertise application to court</td>
<td>&gt; 1 week prior to hearing</td>
</tr>
<tr>
<td>1st court hearing: “Convening Hearing”</td>
<td>“Hearing Date”</td>
</tr>
<tr>
<td>Notice of meeting sent to all scheme creditors, together with Explanatory Statement</td>
<td>42 days prior to Scheme Creditors Meeting(s)</td>
</tr>
<tr>
<td>Creditors Meeting(s)</td>
<td></td>
</tr>
<tr>
<td>2nd court hearing “Sanctioning Hearing”</td>
<td>21 days after Scheme Creditors Meeting</td>
</tr>
<tr>
<td>Scheme Effective Date</td>
<td>Day following the Sanctioning Hearing</td>
</tr>
<tr>
<td>Notice sent to all Scheme Creditors that Scheme is Effective</td>
<td>Within 14 days of Scheme Effective Date</td>
</tr>
<tr>
<td>Advertise Bar Date</td>
<td>At least 6 weeks before Bar Date</td>
</tr>
<tr>
<td>Scheme Bar Date</td>
<td>90 days from Scheme Effective Date</td>
</tr>
</tbody>
</table>
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