

1

Introduction

Schemes of arrangement, or ‘schemes’, are a valuable and flexible tool for reorganising a company’s capital. They have been around for over a century.¹ The current provisions are found in Part 26 of the Companies Act 2006. Section 895(1) defines a scheme of arrangement as ‘a compromise or arrangement between a company and its creditors, or any class of them, or its members, or any class of them’. A scheme of arrangement is therefore a statutory mechanism for the implementation of a wide range of corporate transactions. However, the statutory provisions provide relatively few details regarding the operation and utilisation of schemes, and consequently much of the law in this area has been developed by the courts.

This chapter will provide an introduction to schemes, and also to this book, introducing some of the themes and ideas that will be developed in detail in later chapters. In section 1.1 a general overview of schemes is provided, including a consideration of some of the main uses to which schemes are put, and also the main advantages and disadvantages of this mechanism. In section 1.2 the historical development of schemes will be examined, in order to provide some context for the current statutory provisions. In section 1.3 the purpose and scope of this book will be discussed, including a summary of the contents and function of each of the chapters that follow, and an introduction to the main arguments and ideas that will be pursued therein.

1.1 An overview of schemes

The statutory provisions in the Companies Act 2006 do not prescribe the subject matter of a scheme and, in theory, a scheme could be a compromise or arrangement between a company and its creditors or members about anything that they can properly agree amongst

¹ See section 1.2.

themselves. As a result, companies can use schemes for a wide variety of internal reorganisations of debt and/or equity capital, as long as the necessary approvals have been obtained.² Schemes of arrangement have not always been valued. As recently as 2000, it was common for them to be regarded as a complex, cumbersome and costly procedure of little practical value to companies, particularly as a debt restructuring tool.³ However, in recent years schemes have enjoyed something of a renaissance. They have become popular as a mechanism to effect a takeover of a target company by a bidder. They are also used regularly as a mechanism for restructuring financially distressed companies. Indeed, the value of the English scheme of arrangement for rehabilitating financially distressed companies is such that it has become common for companies incorporated outside the UK to seek to make use of this mechanism.⁴ Although these are the most common forms of scheme, there are many other corporate restructurings or reorganisations that can be (and are) effected via schemes. This renaissance owes much to the development of the scheme jurisdiction by the English courts, and in particular to the pragmatic and commercially sensible line that the courts have tended to adopt regarding schemes of arrangement.

Schemes have many advantages that help companies to reorganise their debt and/or equity capital effectively. One of these benefits is their flexibility. At the core of the scheme is the idea that it can be used by companies, creditors and members to agree a very wide range of reorganisations or alterations in relation to the company's capital, provided that the agreement is subsequently sanctioned by the court. This enables schemes to be used either as an alternative to or alongside more

² See e.g. *Scottish Lion Insurance Co Ltd v. Goodrich Corp* [2010] CSIH 6; 2010 SC 349, in which the Lord President confirmed that there was nothing in the legislation to suggest that a solvent scheme of arrangement should be treated differently from an insolvent one; cf. the view of Lord Glennie at first instance in *Scottish Lion Insurance Co Ltd v. Goodrich Corp* [2009] CSOH 127; 2010 SLT 100. One question that has arisen recently is whether the Aircraft Protocol to the Cape Town Convention, 16 November 2001, imposes any restrictions on the court's power to sanction a scheme of arrangement; for discussion see *Re MAB Leasing Ltd* [2021] EWHC 379 (Ch).

³ See *Report of the Joint DTI/Treasury Review of Company Rescue and Business Reconstruction Mechanisms* (2000) at para. 43. For a slightly earlier but similar opinion see Report of the Insolvency Law Review Committee (Cork Committee), *Insolvency Law and Practice* (Cmnd 8558, 1982) ch. 7. Similar comments were made about creditor schemes in Australia, leading to the introduction of deed of company arrangements in 1993: Australian Law Reform Commission, 'General Insolvency Inquiry', Report No. 45, 1988 Vol 1 at 25–6 and 31.

⁴ See Chapter 7.

traditional mechanisms for reorganising a company's capital. As we shall see, schemes can provide some advantages over the more traditional methods. For example, Chapter 3 explores why schemes are often the mechanism of choice for recommended takeovers, rather than the more traditional takeover offer. Schemes can also be used to effect reorganisations of the company, or its debt or equity capital, that could not be achieved easily by other means alone. So, for example, it is possible to use a scheme to redomicile a corporate group, something for which there is no mechanism under the Companies Act 2006.⁵

A second advantage of schemes is the finality and certainty that a completed scheme can provide to the parties. Once a scheme has been approved by members and creditors and sanctioned by the court, it will be set aside subsequently only in very limited circumstances. In general this will be only if the consent of the members and/or creditors was obtained by fraud.⁶ This stands in contrast to some of the alternative mechanisms discussed in this book, under which the transaction may remain open to challenge for some considerable period after it is complete, providing an ongoing risk for the company.⁷

A third, significant, advantage of a scheme is the fact that it allows a majority of the members or creditors to bind the minority. If a 'majority in number representing 75% in value'⁸ of the creditors or members (or class of them) vote in favour of the scheme, and the scheme is subsequently sanctioned by the court, then it will bind all of the company's members or creditors in the relevant classes and the company itself.⁹ This ability of the majority to bind the minority can be very useful. In debt reorganisations, for example, it is generally the case that creditor rights cannot be varied without the creditors' consent. A single dissenting creditor can therefore prevent the reorganisation. As a result, the minority have potential hold-up opportunities, which can be bypassed through the use of a scheme. This ability of the majority to bind the minority might appear less useful for member schemes, since there are other mechanisms in company law that allow the majority to bind the minority.¹⁰ However,

⁵ See section 4.2.1.1.

⁶ See section 2.5.

⁷ See e.g. company voluntary arrangements (CVAs), discussed in section 5.6.

⁸ Companies Act 2006, s. 899(1).

⁹ If the company is in the course of being wound up it will also bind the liquidator and contributories of the company: *ibid.*, s. 899(3). The scheme becomes effective once a copy of the order sanctioning the scheme is delivered to the Registrar of Companies: s. 899(4).

¹⁰ E.g. Companies Act 2006, s. 21, which allows the articles of the company to be amended by a special resolution.

even here, schemes can be useful, for example where there are a number of untraceable shareholders who must be bound by the scheme.¹¹ The fact that the ‘majority in number representing 75% in value’ can bind the minority also means that bidders contemplating a takeover can acquire 100 per cent of the target shares more easily than is possible under a traditional takeover offer, which is a significant reason for the attractiveness in practice of schemes in this context.¹²

The ability of the majority to bind the minority in a scheme is sometimes described as a ‘cramdown’. However, it is important to use this term with care. In particular, the form of majority decision achievable in an English scheme is distinct from the form of cramdown available in other jurisdictions. In Chapter 11 proceedings in the USA, for example, it is possible for a whole class of creditors to be crammed down, that is, to have their rights adjusted without their consent. A similar form of cramdown is also possible in other jurisdictions, for example in Irish examinership proceedings,¹³ and in the Part 26A restructuring plans introduced in the UK by the Corporate Insolvency and Governance Act 2020.¹⁴ By contrast, the English scheme allows only the minority creditors or shareholders *within* a class to have their rights varied without their consent. Every class of members and creditors with a vote on the scheme must consent to it before the scheme will be sanctioned by the court. This is, therefore, a more limited form of cramdown, namely a cramdown of the minority within a class rather than a cramdown of a whole class. Nevertheless, this ability of the majority of a class to bind the minority can be extremely important and is one of the reasons for the popularity of the English scheme.

The majority decision-making that schemes facilitate inevitably gives rise to issues of minority protection. In order to provide that protection, and to prevent oppression, there is close court supervision of the scheme process. Two court hearings are involved.¹⁵ The first sets up the requisite meetings of creditors or members (or classes thereof), with the meetings themselves conducted under the auspices of the court, and in accordance

¹¹ See e.g. *Re BAT Industries plc*, unreported, 3 September 1998, discussed in section 4.4.

¹² Under a traditional offer the bidder would have to acquire 90 per cent of the target shares before it can make use of the squeeze-out rule and be sure of obtaining 100 per cent of the target shares: see section 3.3.2.2.

¹³ See Irish Companies (Amendment) Act 1990 as amended by Irish Companies (Amendment) (No. 2) Act 1999, Part II.

¹⁴ For discussion see section 5.8.

¹⁵ More court hearings may be required in some circumstances; for example, where the scheme involves a reduction of capital an additional court hearing may be required to approve the reduction.

with directions given by the court, and considers certain jurisdictional issues.¹⁶ The second meeting considers whether the scheme should be sanctioned. This is not a mere rubber-stamping exercise. The court has discretion to sanction a scheme of arrangement; it is certainly not obliged to do so, and there is no entitlement to have a scheme sanctioned.¹⁷ As a result, the court can refuse to sanction a scheme even where the relevant classes have approved it. The ability of the majority to bind the minority to agree to a compromise or arrangement of the minority's existing rights is both the great benefit of schemes (to the majority) and their potential danger (to the minority). Properly balancing the interests of the majority and the minority is perhaps the central task for the courts in this area.¹⁸ The fact that the courts are so heavily involved in them provides schemes with a dual nature: they are at once agreements between the parties (the company and its members and/or creditors) and court-sanctioned arrangements.

As regards disadvantages, schemes are sometimes perceived to be 'complex, cumbersome and expensive' in nature.¹⁹ This is largely a consequence of the significant court supervision of schemes. The fact that two court hearings are involved has implications for the time required for a scheme (the minimum time required to effect a scheme is generally six to eight weeks) and for its costs. In a complex scheme, these disadvantages might be overstated. One of the other significant contributors to the view of schemes as complex and cumbersome is the requirement to separate groups of members and creditors into classes to consider and vote on the scheme. This requirement creates logistical and categorisation difficulties for schemes, and is undoubtedly one of the trickier issues facing a company wishing to make use of this mechanism. This is an issue that is discussed extensively in this book.²⁰ However, the courts have recently taken a more flexible approach towards the issue of classes in schemes,²¹ and it may be that the impact of this requirement

¹⁶ See section 2.2.3.

¹⁷ *Scottish Lion Insurance Co Ltd v. Goodrich Corp* [2010] CSIH 6; 2010 SC 349 at [36] *per* Lord Hamilton, the Lord President. For discussion of the exercise of the court's sanctioning role see section 2.4.3.

¹⁸ See e.g. J. Payne, 'The role of the court in debt restructuring' (2018) *Cambridge Law Journal* 124.

¹⁹ See *Report of the Joint DTI/Treasury Review*, note [3] above, at para. 43.

²⁰ See section 2.3.2 for a general discussion of this issue, section 3.5.2 for a discussion of this issue in the context of member schemes and section 5.3 for a discussion of this issue in the context of creditor schemes.

²¹ See e.g. David Richards J in *Re Telewest Communications plc (No. 1)* [2004] EWHC 924 (Ch). This is discussed further in section 2.3.2.

has lessened somewhat. Instead, the courts now tend to leave much of the discussion of minority protection issues until the sanctioning hearing, at which the courts have discretion whether to allow or refuse a scheme. This, of itself, can raise concerns, since the court's exercise of its discretion can provide a level of uncertainty, and risk, for the parties.

The renaissance of schemes of arrangement over the last twenty years or so has not been uncontroversial. Concerns have been raised about the use of schemes to effect takeovers, the suggestion being that the use of schemes in this context allows bidders to bypass takeover regulation or other measures put in place to protect minorities in a takeover, or that target shareholders are otherwise being disadvantaged by the bidder's use of a scheme, rather than an offer, to effect the change of control.²² The use of schemes to restructure financially distressed companies in a way that effectively disenfranchises junior creditors has been criticised by those who consider that such schemes treat the junior creditors unfairly.²³ Another difficult issue that has arisen concerns the ability of companies incorporated outside the UK to make use of the English scheme jurisdiction. These issues will be debated in the following chapters.

This is a dynamic area of the law. Both in the UK and in other jurisdictions that make use of schemes there has been a wealth of case law and legislative developments in recent years, in some instances responding to concerns about the use to which schemes have been put, in others responding to more general concerns. Most recently in the UK, the Corporate Insolvency and Governance Act 2020 has introduced significant changes to the UK debt restructuring regime in order to respond to the economic effects of the Covid-19 pandemic.

1.2 The historical development of schemes

The origins of the scheme of arrangement lie in the Companies Act 1862. Section 136 of that Act provided for an arrangement entered into between a company and its creditors, but only where the company was about to be, or was in the course of being, wound up voluntarily. Such an arrangement would be binding on the company if sanctioned by an extraordinary resolution (75 per cent of all members), and on its

²² See section 3.7 for discussion of this issue.

²³ See section 5.6 for a discussion of this issue.

creditors if acceded to by 75 per cent of their number and value.²⁴ There was no requirement for court approval of this arrangement. However, section 137 gave any creditor or contributory of a company that had already entered into such an arrangement three weeks to appeal against it to the court, and the court then had power to amend, vary or confirm the arrangement. Where a company was being wound up compulsorily, or subject to supervision, section 159 of the Companies Act 1862 empowered a liquidator, with the sanction of the court, to enter into compromises with creditors and contributories. Where the company was being wound up voluntarily, section 160 empowered a liquidator to make such compromises with the sanction of an extraordinary resolution of the company. These later sections provided the court with no jurisdiction to bind dissenting creditors.

Section 2 of the Joint Stock Companies Arrangement Act 1870 was introduced to tackle some of these issues. It was a rudimentary ancestor of sections 895–9 of the Companies Act 2006. However, its scope was still limited to compromises or arrangements proposed between a company that was in the course of being wound up, voluntarily, compulsorily or under supervision, and its creditors or any class of them:

Where any compromise or arrangement shall be proposed between a company which is, at the time of the passing of this Act or afterwards, in the course of being wound up, either voluntarily or by or under the supervision of the Court, under the Companies Acts 1862 and 1867, or either of them, and the creditors or such company, or any class of such creditors, it shall be lawful for the Court, in addition to any other of its powers, on the application in a summary way of any creditor or the liquidator, to order that a meeting of such creditors or class of creditors shall be summoned in such manner as the Court shall direct, and if a majority in number, representing three-fourths in value, of such creditors or class of creditors present either in person or by proxy at such meeting shall agree to any arrangement or compromise, such arrangement or compromise shall, if sanctioned by an order of the Court, be binding on all such creditors or class of creditors, as the case may be, and also on the liquidator and contributories of the said company.

²⁴ The approval requirement was for 75 per cent of all members and creditors, not just 75 per cent of those members present and voting as is the case today (Companies Act 2006, s. 899(1)).

Accordingly, the compromise or arrangement had to be approved by a 75 per cent majority in value, and a simple majority in number, of the creditors present either in person or by proxy, and then sanctioned by the court. The fact that this provision allowed for the minority creditors to be bound by a majority decision of the relevant class was a crucial innovation of this section. It was understood that companies dealing with classes of debenture holders had faced a significant difficulty before the 1870 Act:

before the legislation of 1870, any particular individual could hold out against a scheme, however meritorious and however beneficial it might be, in order that he might get, generally speaking, some special advantage for himself, or because he was a person who did not even take a fair view of the advantages to be gained. It was for the purpose of preventing that obstruction that the legislature passed the Joint Stock Companies Arrangement Act 1870.²⁵

That remained the position until 1900, when section 24 of the Companies Act 1900 applied the provisions of section 2 of the 1870 Act ‘... not only as between the company and the creditors, or any class thereof, but as between the company and the members, or any class thereof’. Under these provisions it was still necessary at that time that the company should be in the course of being wound up, but a report of the Loreburn Law Amendment Committee submitted that it was inconvenient that a winding-up should be a condition precedent to the court approving an arrangement and this led to a change in the law.²⁶ Section 38 of the Companies Act 1907 provided that the Act of 1870 should also apply to a company that was not in the course of being wound up. Section 39 of the 1907 Act gave a company power by special resolution, confirmed by an order of the court, to modify its memorandum of association so as to reorganise its capital ‘... whether by the consolidation of shares of different classes, or by the division of its shares into shares of different classes ...’.²⁷

In the following year the Companies (Consolidation) Act 1908 was passed and in section 120 there appeared for the first time a readily recognisable predecessor of section 899(1) of the Companies Act 2006, requiring ‘a majority in number representing three-fourths in value of the

²⁵ *In re Dominion of Canada Freehold Estate and Timber Co Ltd* (1886) 55 LT 347 at 351 per Chitty J.

²⁶ Loreburn Committee, Report 1906 Cd. 3052 (London: HMSO, 1906).

²⁷ See e.g. *Re Palace Hotel Ltd* [1912] 2 Ch 438.

creditors or class of creditors, or members or class of members, as the case may be, present either in person or by proxy at the meeting' to agree to the compromise or arrangement.²⁸ The only difference was that at that stage the words 'and voting' did not appear after the word 'present'. As a result, under that Act an abstention was still effectively a vote against the scheme.²⁹

However, that and other amendments were made by section 53 of the Companies Act 1928. As a result, the member and creditor approval requirement was changed so that it would operate by reference to those members and creditors 'present *and voting* either in person or by proxy'.³⁰ Consequently, an abstention at the meeting was no longer treated as a vote against the arrangement, effectively lowering the approval threshold. In particular, section 45 of the Companies (Consolidation) Act 1908, which had re-enacted section 39 of the Companies Act 1907, ceased to have effect. It was, in effect, replaced by the extension of the definition of 'arrangement' that is now found in section 895(2) of the Companies Act 2006, that is, that the term 'arrangement' includes a reorganisation of share capital by consolidation of shares of different classes or the division of shares into shares of different classes.³¹ This was then followed by sections 153–4 of the Companies Act 1929, another consolidating act.

These sections were repeated in almost identical terms in the Companies Act 1948³² and the Companies Act 1985.³³ However, in 1947, following a recommendation of the Cohen Committee,³⁴ a new section added a requirement for an explanatory statement to be provided.³⁵ This section was re-enacted in the Companies Act 1948,³⁶ the Companies Act 1985³⁷ and the Companies Act 2006.³⁸ Prior to this, common law disclosure obligations had applied. This statutory enactment required that any disclosures be fair, that material interests of directors and the trustees of debenture stock be disclosed, and that where an explanatory

²⁸ Companies (Consolidation) Act 1908, s. 120(2).

²⁹ *Re Savoy Hotel Ltd* [1981] Ch 351 at 359 *per* Nourse J.

³⁰ Companies Act 1928, s. 53(3) (emphasis added). The words in italics are those added by this section.

³¹ See now Companies Act 2006, s. 895(2).

³² Companies Act 1948, ss. 206–8.

³³ Companies Act 1985, ss. 425–7.

³⁴ The Report of the Committee on Company Law Amendment (Cmnd 6659, 1945) (Cohen Report).

³⁵ Companies Act 1947, s. 40.

³⁶ Companies Act 1948, s. 207.

³⁷ Companies Act 1985, s. 426.

³⁸ Companies Act 2006, s. 897.

statement was provided it should contain all of the information reasonably necessary to enable the recipients to determine how to vote.³⁹

The provisions dealing with schemes of arrangement are now found in Part 26 of the Companies Act 2006. The Company Law Review that preceded this Act considered reforms to the statutory provisions relating to schemes alongside its more general consideration of company law reforms. It recommended that a number of changes be made, including giving the court the power to make a binding determination on the composition of classes at the first court hearing; giving the court discretion to sanction a scheme of arrangement notwithstanding a technical defect in compliance with the statutory procedure, provided this had no substantive effect on the outcome; providing a definition of ‘class’ within the legislation; giving the court the power to direct the manner in which scheme meetings are called, held and conducted; and abolishing the majority-in-number requirement for member or creditor sanction of a scheme.⁴⁰ Despite initial indications that these ‘generally technical changes’ would be introduced into the legislation,⁴¹ in the end none of these important recommendations were included in the legislative provisions.⁴² However, a Practice Statement in 2002 at least dealt with the Company Law Review’s concern regarding the need for the court to consider at the first rather than the second court hearing whether class meetings have been correctly constituted.⁴³

There is no public explanation of why the government did not proceed with these proposed reforms. The concern seems to have been the potentially adverse impact on minority rights. Three of the proposed reforms (the ability of the court to determine classes at the first meeting, the discretion to approve a scheme even where the classes were not formally constituted, and abolishing the headcount test) were debated by the House of Lords’ Grand Committee, when considering the Companies Bill. In that Committee the Attorney General stated that these amendments would weaken safeguards for individual members and creditors that existed in the law, and that ‘while I can see that they

³⁹ E.g. *Kaye v. Croydon Tramways Co* [1898] 1 Ch 358; *Re Dorman Long and Co Ltd* [1934] Ch 635.

⁴⁰ CLR, *Final Report*, URN 01/942, July 2001 paras. 13.5–13.11.

⁴¹ DTI, *Company Law Reform – White Paper*, March 2005, para. 4.14.

⁴² For discussion of these issues see sections 2.2.3, 2.3.3.2 and 2.4.2.

⁴³ Practice Statement [2002] 3 All ER 96, which has subsequently been replaced by Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006) [2020] 1 WLR 4493; for discussion see section 2.2.3.