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Schemes under scrutiny: recent developments provide further guidance to companies considering the procedure

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Despite commentators' recent focus on the new Part 26A restructuring plan, introduced in late June by the Corporate Insolvency and Governance Act 2020, the scheme of arrangement under Part 26 of the Companies Act 2006 ("scheme") remains a popular tool for companies to reach a compromise or arrangement with their creditors and/or its members.

On 18 September 2020, Mr. Justice Snowden handed down his judgment with respect to a scheme proposed by Sunbird Business Services Limited, the holding company of a group providing serviced offices in Africa. The judgment provided guidance as to information that should be provided to creditors in advance of scheme meetings, and included commentary as to the use of lock-up agreements, and the payment of associated lock-up fees. This guidance and commentary is helpful for companies considering the scheme process.

Provision of information to creditors

The English court's discretion in deciding whether to sanction a scheme is an important safeguard against the oppression of a dissenting minority of scheme creditors. A compromise or arrangement should only be imposed upon that dissenting minority if the company can demonstrate '*scrupulously fair and accurate compliance*' with the relevant law. The judge noted that '*the court is not involved simply to rubber-stamp the wishes of the majority*'. The court must be satisfied that scheme creditors have been '*properly consulted*', and to satisfy this test an 'explanatory statement' should be provided to scheme creditors, setting out the commercial impact of the proposed compromise or arrangement, and "*such information as is reasonably necessary to enable them to make an informed decision as to whether or not the scheme is in their interests*."

Although the Sunbird scheme was approved at the creditors meeting, the judge refused to sanction the scheme, highlighting a '*paucity of information provided by the company as part of the scheme process*', and a failure to engage with creditors '*whom the directors clearly felt were irrelevant or would be an obstacle to their plans*'. He remarked that the company's approach "*fell a considerable distance short of what was required for a fair process*".

He highlighted a failure to provide in the explanatory statement detailed information in relation to the group's financial position, or in relation to the anticipated impact upon creditors in the event that, absent a successful scheme, the company were to enter into an insolvency process. The judge was concerned that additional financial information had been provided to some, but not all scheme creditors. Initially, certain directors' interests in the scheme were not disclosed, and although the relevant information was eventually provided in advance of scheme meetings, the judge determined that creditors did not have sufficient time to consider such interests before their vote. The scheme contemplated a debt-to-equity swap and rights issue; the judge raised concerns that the valuation methodology relating to the relevant shares was not adequately explained.

In his judgment, Mr. Justice Snowden noted:

1. The explanatory statement should describe how different groups of creditors and any other relevant stakeholders are treated under the scheme and any wider restructuring process, in order that creditors can reach an informed view as to whether the losses which have been suffered and the available value are being appropriately allocated between stakeholder groups.

2. If certain creditors would rank *pari passu* in an insolvency, but are treated differently under the scheme, or if some of those creditors are left out of the scheme and are not subject to a compromise under the scheme, this should be fully disclosed and explained.

3. Any underlying assumptions and valuation methodologies should be clearly explained, so that creditors can reasonably assess whether the allocation of losses and the division of benefits among stakeholders is appropriate and fair.

4. Any financial and commercial interests of the directors should be fully disclosed.

5. The advice or opinion of any independent advisor or expert should be accompanied by full disclosure of the identity of the relevant advisor or expert, the terms and methodologies upon which the relevant advice or opinion was prepared, and whether or not such person(s) are prepared to accept responsibility (and therefore owe a duty of care) to the scheme creditors.

Lock-up fees

Justice Snowden made certain observations in his judgment in relation to lock-up agreements, and the payment of associated lock-up fees. It is commonplace for a company to use a lock-up agreement to seek significant creditor support before commencing a scheme process. If a creditor accedes to a lock-up agreement, it agrees, subject to certain conditions, to support the proposed scheme, and a lock-up fee is often offered as consideration for a creditor's support.

Justice Snowden noted that scheme creditors may receive differing levels of information in relation to the relevant business and the scheme, depending on whether such creditor accedes to a lock-up agreement, and if it does accede, when it becomes a party to the agreement. For example, creditors involved in preliminary negotiations and amongst the initial parties to the agreement could receive differing information to those who accede later. Further issues can arise once the scheme process is launched, as certain creditors may have agreed to support the scheme on the basis of more, or less, information than is contained in the explanatory statement and scheme document. The judge questioned whether the payment of lock-up fees should result in the court ordering that creditors who had received the fee should be placed into a separate class.

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