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***Schemes of Arrangement and Restructuring of Companies:  
A Viable Alternative to Other Restructuring Tools in Corporate Law***

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## **Abstract**

Due to globalisation of trade and the growth of diverse, competitive and volatile markets, companies have for many decades developed and adapted, expanding their structures into a complex web of operations with varied roles, purposes and management needs. There is no single 'type' of corporation, nor any 'one size fits all' list of what each individual organisation will require during its cyclical life. Company law frameworks have therefore sought to accommodate multifarious demands for the fostering of a vibrant commercial domestic, regional and international market environment.

Restructuring imperatives may be a result of expansion or potential demise occasioned by financial strain or other economic challenges and the need for rescue to preserve the value of business organisations to domestic economies. Complex, 'single purpose' restructuring processes have traditionally dealt with mergers, acquisitions, takeovers and, more recently, insolvency. In the case of financial distress, most developed jurisdictions adopted a 'scheme of arrangement' procedure to facilitate renegotiation, refinancing and rescue, as well as a proposal to reorganise liabilities and indeed effect organisational restructure. Schemes of arrangement has proven to be more flexible and has been adapted to manage institutional change. This has been particularly valuable in the rationalisation of complex multinational conglomerates, facilitating continued expansion, be it generically or by takeover.

This study examines the framework and use of schemes of arrangement as an effective mechanism for companies of all sizes and formations to restructure their liabilities and operations in diverse national jurisdictions, with particular focus on the UK and the KSA. The other processes may continue to have their uses, but the scheme provides a relatively simple structure in the face of significant complexity. It is monitored by the courts with only limited intervention in what are essentially business decisions of the management supported by the special majority of those affected.

Indeed, the relatively ubiquitous use of schemes of arrangement as a corporate legal service has proven to be an attraction for corporations seeking the jurisdiction most amenable to their plans 'forum shopping'. It is thus a valuable marketing tool for economies in attracting company operations to the provider country. To achieve this, the KSA, a major focus of this study, has made substantial changes to the basis of its economy and reformed its bankruptcy law to facilitate corporate needs by the introduction of a scheme of arrangement framework accommodating *Shari'a* principles for a global market awash with opportunity as well as risk.

***Declaration***

I hereby certify that this submission is my own work; that it has not been submitted substantially in the same form for an award of another degree at any institute of higher education; and that all quotations have been distinguished and the sources of identification have been acknowledged.

## **Acknowledgement**

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## **1. Chapter I: Introduction**

### **1.1. Overview**

This thesis deals with schemes of arrangement, a subject of crucial importance in terms of the economic performance of commercial organisations in a dynamic and uncertain context of national economies operating in a fiercely competitive global market. Such schemes constitute a set of tools traditionally used to assist corporations, whether facing insolvency or seeking to avoid that risk, to effect organisational and debt restructuring in order to survive, or at least provide best value for its creditors. Attention is paid to the rationalisation purpose of schemes, as companies experiencing growth, expansion and acquisition reorganise their structure to effect more adaptable and efficient arrangements for management.

It is commonly assumed that insolvency is the result of poor management caused by non-alignment of culture, strategy, goals, processes and functions within or outside an organisation, or of bad decisions and investments.<sup>1</sup> In consideration of the effect of the new Saudi Bankruptcy Law in Chapter IV, it will be noted that this has, in fact, been the prevailing philosophy of the pre-existing legislation. This may be true in some cases, but the commercial reality of the contemporary market is such that there are multiple factors that may plunge a company into financial crisis as global competition increases and methods of doing business change.

Free trade dominates and the borders between nations are, in business and financial terms, so fluid that they essentially constitute little more than lines on a map, facilitated by the global communications technology revolution and the emergence of e-commerce. Online global trading platforms, such as Alibaba.com, Amazon and eBay, allow fledgling companies and their customers to access world markets. Failure to adapt to a fundamentally changing, volatile and more highly competitive market will in all likelihood result in decline and failure. This was the experience of internationally renowned UK global retailer Woolworths which tried to continue

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<sup>1</sup> Alan N Rechtschaffen, *Capital Markets, Derivatives and the Law: Evolution after Crisis* (Oxford University Press 2014) 26-30.



with its failing, 'last century' business model, sharing its destiny with such retail staples as BHS and HMV.<sup>2</sup> Legal tools and processes are available for restructuring in an evolving global market where management has the foresight to use them. Failure to adapt to a vibrant changing market has a ripple effect on the fates of, for example, related material and service suppliers, customers and creditors, as was the case in the Carillion collapse of 2018.<sup>3</sup> The Tesco mismanagement and accounts fraud of 2015 resulted in the cancellation of plans for diverse businesses from sandwich shops to housing development across the country.<sup>4</sup> Corporate demise has a high level of collateral damage and its avoidance is a legal imperative.

Vibrancy, volatility and increased competition for market advantage demand a capacity to change and diversify, not simply in terms of how companies manage their operations and liabilities but in providing legal structures which facilitate their adaptation to new challenges and developments. Threats abound from economic unpredictability, putting the future of corporations at risk, but these also give rise to opportunities which require restructuring to gain and preserve market advantage. Tetreova asserts that "restructuring represents an essential reconstruction of an enterprise strategy, structures and processes and their tuning with the new reality".<sup>5</sup> It is not therefore of itself evidence of financial distress, as suggested by Vance,<sup>6</sup> or the last stages of the company's lifecycle before its demise.<sup>7</sup> Rather, it may be indicative of renewal and regeneration, the planning for changes in regulation and law, political change,

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<sup>2</sup> Tom Braithwaite, Elizabeth Rigby and Jean Eaglesham, 'Woolworths Falls into Administration' (Financial Times 27 November 2008) <<https://www.ft.com/content/b9918572-bbd1-11dd-80e9-0000779fd18c>> accessed 20 September 2019.

<sup>3</sup> Tamlyn Jones, 'Bank of England plays down risk to Carillion's lenders' (Business Live 16 January 2018) <<https://www.business-live.co.uk/business/finance/bank-england-plays-down-risk-14163614>> accessed 20 September 2019.

<sup>4</sup> John Harris, "We feel betrayed": the towns abandoned by Tesco' (The Guardian 2 February 2015) <<https://www.theguardian.com/business/2015/feb/03/betrayed-by-tesco-kirkby-bridgwater-wolverhampton-let-down-by-supermarket-regeneration>> accessed 20 September 2019.

<sup>5</sup> Libena Tetreova, 'Concept of Corporate Restructuring and Re-engineering' (University of Pardubice 2007) <<https://pdfs.semanticscholar.org/e34e/143c1a361e1707dc50e8db255dee92636255.pdf>> accessed 20 September 2019.

<sup>6</sup> David Vance, *Corporate Restructuring: From Cause Analysis to Execution* (Springer 2010) 1-3.

<sup>7</sup> Szeekoo Koh, Lele Dai and Millicent Chang, 'Financial Distress: Lifecycle and Corporate Restructuring' (2015) 33(C) Journal of Corporate Finance 19.

technological advancement, new management, downsizing, change of business operation focus and merger.<sup>8</sup>

A pertinent UK example of positivity of adaptive action in response to political change is the scheme of arrangement by Barclays Bank, approved by the High Court, to move management of assets to Ireland to preserve post-Brexit access to the European market.<sup>9</sup> The schemes which effect such separation of high risk investment activities to protect normal banking services enable banks to ring-fence activities under EU Regulatory Proposals, introduced in 2014 as a response to the 2008 crash which required government intervention to 'save' major institutions.<sup>10</sup> Indeed, although the UK seeks withdrawal from EU Regulatory compliance, it is arguably in the commercial and strategic interests of UK banks to separate their functions on the basis of risk to ensure crisis survival in the event of an inevitable future downturn. This is achievable by restructure scheme. Although much attention is focused by the jurisdictions examined in this study on financial distress and corporate rescue, sight should not be lost of the positive use of the scheme of arrangement in promoting adaptation and continuing success. In the UK law, the scheme of arrangement is legislated for in company law, not insolvency regulations.<sup>11</sup>

Schemes of arrangement to effect corporate restructure and ease insolvency risk in national economies provide a vital flexible resource for the attraction of foreign business and development of a diverse domestic entrepreneurship environment. A particular focus of this

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<sup>8</sup> Ronald J Recardo and Kleigh Heather, 'Ten Best Practices for Restructuring the Organization' (2013) 32(2) *Global Business and Organizational Excellence* 23.

<sup>9</sup> Paul Clarke, 'Barclays Prepares to Shift €190bn of UK Assets to Ireland' (Financial News 30 January 2019) <<https://www.fnlondon.com/articles/barclays-prepares-to-shift-e190bn-of-uk-assets-to-ireland-20190130>> accessed 20 September 2019.

<sup>10</sup> European Commission, 'Proposal for a regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions' COM (2014) 43 final, <<https://ec.europa.eu/transparency/regdoc/rep/1/2014/EN/1-2014-43-EN-F1-1.Pdf>> accessed 20 September 2019. See also Iain Hardie and Huw Macartney, 'EU ring-fencing and the defence of too-big-to-fail banks' (2016) 39(3) *West European Politics* 503.

<sup>11</sup> Weil LLP, 'Schemes of Arrangement as Restructuring Tools' (Weil, 2015) 2 <[https://eurorestructuring.weil.com/wp-content/uploads/2015/01/140553\\_LO\\_BFR\\_Schemes\\_Arrangement\\_Brochure\\_v12.pdf](https://eurorestructuring.weil.com/wp-content/uploads/2015/01/140553_LO_BFR_Schemes_Arrangement_Brochure_v12.pdf)> accessed 20 September 2019.

examination is on the new Saudi Bankruptcy Law, the enactment of which is designed to clarify and expand a new phase of corporate law in the KSA as it pursues a policy of diversification in its domestic economy. Considerable change is evident in developing commercial and legal attitudes in the KSA as it grows in the globalised markets.

## **1.2. Background**

Company law provides numerous corporate restructuring tools,<sup>12</sup> but the primary focus of this research is schemes of arrangement. It is proposed to address whether it is possible to create an international scheme of arrangement regime that would respond to the needs of, and flexibility demanded by, a globalised market, free trade and the fluidity of national borders in the context of regional or global commerce and transnational business.<sup>13</sup> From a purely pragmatic point of view, it would have to provide a 'coherent fit' with the contemporary business environment.

Schemes of arrangement that effect corporate restructuring have become more common since the 2008 global financial crisis as companies have sought to restructure their organisation and liabilities to deal with the new threats to survival.<sup>14</sup> They necessarily alter pre-existing relationships with, and obligations to, shareholders and creditors, members and investors, as well as the company and its management. Baines notes that a benefit of a scheme is that it is a means of binding dissenting minorities under section 889(3) of the Companies Act 2006 (CA 2006) and so is attractive to those wanting to restructure but such an effective result is not allowed by their local jurisdiction.<sup>15</sup> It incorporates greater flexibility for the company to establish new, enforceable contractual relationships which bind creditors not available in the UK's Company Voluntary Arrangement (CVA) measures under section 4 of the Insolvency Act

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<sup>12</sup> See Chapter I, 1.5.

<sup>13</sup> See Chapter V, 5.3.2.

<sup>14</sup> Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge University Press 2014) 383.

<sup>15</sup> Richard Baines, 'Schemes of Arrangement of Overseas Companies' (Druces LLP, Legal Briefing – Finance 1 September 2014) <<http://www.inhouselawyer.co.uk/legal-briefing/schemes-of-arrangement-of-overseas-companies/?pdf=1852>> accessed 20 September 2019.

1986 (IA 1986) of which, in default, leave the pre-existing obligations actionable.<sup>16</sup> It is not binding on secured creditors and this limits the extent to which broader restructure can be effected where necessary.<sup>17</sup>

International recognition of the newly restructured company is only achievable where the national law of the state in which the fundamental corporate change is effected has credibility in its legal restructure process. Without this, there is little point in a restructure, especially where the company has a global presence. The UK courts, for example, are not going to exercise their discretion to sanction a scheme if it is clear that the scheme is not likely to be enforced overseas.<sup>18</sup> They would probably also consider such an exercise of their jurisdiction to be both pointless and disproportionate.<sup>19</sup> The courts have been willing to exercise jurisdiction over foreign company restructure, where there is sufficient connection to the jurisdiction and the principle of rescue is supported by the majority of international creditors, reflecting the role of the UK law in promoting the rehabilitation imperative.<sup>20</sup>

Each state examined in this study has legislative jurisdictional demands aiming to attract the business of corporate services and restructuring, which represents a burgeoning market for legal services.<sup>21</sup> International relationships in customary law and by treaty are expected to require recognition of the schemes of arrangement effected in other jurisdictions, and the new obligations which have replaced the old. The law must facilitate the business demands which

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<sup>16</sup> See *SHB Realisations (Ltd) (formerly BHS Ltd) (In Liquidation) Wright v Prudential Assurance* [2018] EWHC 402 (Ch).

<sup>17</sup> Keith Steven, 'Expert Guide to the Company Voluntary Arrangement Process' (Company Rescue 2014) <<https://www.companyrescue.co.uk/fileadmin/uploads/cr/Documents/Company-voluntary-arrangement-CVA-guide-v2.pdf>> accessed 20 September 2019.

<sup>18</sup> *Weil LLP (n 11) 9* and see further the OJSC Bank of Azerbaijan case: *Gunel Bakhshiyeva v Sberbank of Russia* [2018] EWCA Civ 2802.

<sup>19</sup> *ibid* 9.

<sup>20</sup> See *Noble Group Ltd* [2018] EWHC 3092 (Ch).

<sup>21</sup> For example, see The City UK, 'UK Legal Services 2016: Legal Excellence, Internationally Renowned' (TheCityUK 2016) <<https://www.barcouncil.org.uk/media/552526/uk-legal-services-2016.pdf>> accessed 20 September 2019.

protecting associated party interests for companies have a choice where to shop for their service needs.<sup>22</sup>

### 1.2.1. *Corporate Rescue and Business Rescue*

Xie differentiates the aim of ‘corporate rescue’, in the sense of restoring a company to trading efficacy and the continuation of its operation, from that of ‘business rescue’, where the old organisation is liquidated but its business activities, or parts of it, are preserved “as a cohesive, productive unit under new ownership”.<sup>23</sup> In each process, economic viability of the business, or of parts of it, is saved and employment sustained. It is a strategic measure to save the company entity through a legal framework which, in the UK, is not considered an insolvency law procedure but an essential part of corporate management closely related to governance duties. The plan is to return the distressed company to commercial viability and avoid risks of falling into insolvency.<sup>24</sup>

Business rescue, on the other hand, is essentially an asset sale in insolvency with the aim of preserving the operation as a going concern under new ownership. Nwafor asserts that as part of the insolvency procedure the goal is to realise the value of the company’s property and assets, managing the business with the assistance and intervention of a professional advisor to maximise return to creditors.<sup>25</sup> The sale of a business as a going concern will generally produce a greater return and economic benefit than breaking up the assets and selling piecemeal. There is therefore a close relationship between the goals of the rescue processes given that the focus of both company and insolvency legislation is on economic preservation.<sup>26</sup> The focus of this study is on corporate rescue via schemes of arrangement as well as the use of the schemes process in facilitating insolvency through the preservation of business value, often through

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<sup>22</sup> Jennifer Payne, ‘Cross-border Schemes of Arrangement and Forum Shopping’ (2013) 14(4) *European Business Organization Law Review* 563.

<sup>23</sup> Bo Xie, *Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue* (Edward Elgar 2016) 4.

<sup>24</sup> Anthony O Nwafor, ‘The Goal(s) of Corporate Rescue in Company Law: A Comparative Analysis’ (2017) 13 *Corporate Board: Role, Duties and Composition* 20, 22.

<sup>25</sup> *ibid* 26.

<sup>26</sup> Xie (n 23).

merger.<sup>27</sup> This is indicative of their flexibility as part of an orderly procedure to avoid liquidation and its consequences. The 2019 Flybe scheme and takeover by Connect Airlines is an example of imminent winding-up being avoided by the attraction of the company and its business to erstwhile competitors by way of a scheme of arrangement which reorganised the operations of all companies involved.<sup>28</sup> This is discussed further in Chapter II.<sup>29</sup>

### 1.2.2. *Financial Distress and Insolvency*

There is no definition in the former Saudi legislation<sup>30</sup> of what constitutes ‘financial distress’, nor indeed is it a legislative term in any of the jurisdictions examined in Chapter III, save insofar as it relates to the potential for rescue or a precursor to insolvency.<sup>31</sup> Described as a “failure to maintain liquidity”, this must be addressed by the directors as per section 172 of the CA 2006 duty to creditors before the potential for rescue is lost.<sup>32</sup> Although the primary duty of directors is to the company, they are not entitled thereunder to ignore or essentially wish away financial concerns where insolvency looms, nor to simply seek to trade their way out of the liquidity problems.<sup>33</sup> It places directors at risk of liability under section 214 of the IA 1986 for wrongful trading. The court in *MDA Investment Management Ltd*<sup>34</sup> considered distress and a resultant need to liaise with creditors arose where the company, “whether technically insolvent or not, is in financial difficulties to the extent that its creditors are at risk”.<sup>35</sup>

Warning signs which will be apparent to the conscientious company director are generally financial and comprise a weak or negligible cash flow, creditor and bill default arising from falling trading margins and unmanageable loan repayments which require negotiations with

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<sup>27</sup> See, for example, *Flybe* [2019] EWHC 631 (Ch).

<sup>28</sup> Flybe, ‘Recommended Cash Offer for Flybe Group Plc by Connect Airways Limited’ (Announcement 11 January 2019) <[https://www.flybe.com/application/files/6415/4719/1435/Joint\\_Offer\\_-\\_Rule\\_2.7\\_Announcement.pdf](https://www.flybe.com/application/files/6415/4719/1435/Joint_Offer_-_Rule_2.7_Announcement.pdf)> accessed 20 September 2019.

<sup>29</sup> See Chapter II, 2.2.3.

<sup>30</sup> Royal Decree No M/16 of 04/09/1416 (24/01/1996).

<sup>31</sup> Keith Tully, ‘Spotting the Signs of a Client in Distress’ (The Gazette 100742) <<https://www.thegazette.co.uk/all-notices/content/100742>> accessed 20 September 2019.

<sup>32</sup> David Milman, *Governance of Distressed Firms* (Edward Elgar Publishing 2013) 37-38.

<sup>33</sup> See *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250.

<sup>34</sup> [2003] EWHC 2277 (Ch)

<sup>35</sup> *ibid* para 70

creditors for an extension. In the absence of a procedure to address such problems, they will grow from temporary financial issues all companies face in the cycle of business operation into ones that bring about its failure and demise. It is essentially evidenced by a sharp decline in corporate performance, and drops in sales, share value and profitability.<sup>36</sup> It also manifests itself in the structural operation and organisation of the company, with low staff morale, high senior turnover, loss of reputation and difficulties in fulfilling supplier contracts.<sup>37</sup>

Financial distress tends to be cyclical in business, and it will be important to the efficacy of the new Saudi Bankruptcy Law 2018<sup>38</sup> that there is in place alternative financing and support mechanisms for businesses facing problems so that they can work their way through them. Access to working capital may enable businesses to survive the trials of the market or stave off the attention of a creditor. This may be a somewhat temporary fix and restructure will often demand new assets requiring fixed capital resources which have to be negotiated from a financial position of relative weakness. The granting of a charge over existing assets will ease access to new creditor resources, especially insofar as a more easily realisable working property may provide “immediate proprietary interest in the property owned by the company from time to time” secured by a floating charge as such assets are used and replaced.<sup>39</sup> This allows us to reject the suggestion of Purnanandam who asserts that distress and the problems which give rise to the risks of demise are simply an intermediate stage between solvency and insolvency.<sup>40</sup> This belies the fact that it is part of business life, although where unaddressed, or indeed unrecognised, damage may become permanent.

The Supreme Court in *BNY Corporate Trustee Services Ltd v Eurosail* adopted the categorisations of cash flow insolvency, per section 123(1)(2) of the IA 1986 and balance sheet insolvency under section 123(2) where “the value of the company’s assets is less than the

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<sup>36</sup> Richard Whitaker, ‘The Early Stages of Financial Distress’ (1999) 23(2) *Journal of Economics and Finance* 123.

<sup>37</sup> Steven Strom, ‘Recognizing the Signs of Financial Distress’ (Law Journal Newsletter November 2017) <<http://www.lawjournalnewsletters.com/sites/lawjournalnewsletters/2017/11/01/recognizing-the-signs-of-financial-distress/?slreturn=20190308142752>> accessed 20 September 2019.

<sup>38</sup> Royal Decree No M/05 of 28/05/1439 (13/02/2018).

<sup>39</sup> Robert R Pennington, ‘The Genesis of the Floating Charge’ (1960) 23(6) *Modern Law Review* 630, 646.

<sup>40</sup> Amiyatosh Purnanandam, ‘Financial Distress and Corporate Risk Management: Theory and Evidence’ (2008) 87(3) *Journal of Financial Economics* 706.

amount of its liabilities".<sup>41</sup> The case involved problems with the repayment of loan notes issued by Eurosail, a Lehman Brothers subsidiary. In considering the application of the 'point of no return' test, whereby a company is beyond rescue, the fact that liabilities exceed asset value is not conclusive of demise and liquidation.<sup>42</sup> The court must look at the wider commercial context in considering prospects for rescue, not simply paper-based calculations. The Court of Appeal in *BTI v Sequana* asserted that, in the triggering of duties to creditors to advise of risk, 'likelihood' of insolvency meant 'probability'.<sup>43</sup> The primary duty of directors is to the company.

The differentiation between financial distress that is conducive to the rescue and preservation of the company, achievable through the evaluation of scheme, CVA and administration options, or the need for a formal insolvency process, is the judgement to be made by companies, creditors and the courts. The point of no return of liquidation is evidently a last resort finding as per *Eurosail*. The UK legal framework is attractive due to the number of turnaround mechanisms available, the primary recourse for foreign companies being the scheme of arrangement that is negotiated and implemented in a process which allows directors to maintain significant control. Even where insolvency proceedings are instituted, the priority remains rescue, and as such, the evaluation of the degree of financial distress will provide guidance to the court in assessing the just and reasonable nature of the insolvency process being implemented.

### **1.3. The Influence of the UK on Corporate Restructure Principles and Legislation**

The UK is one of the first countries to establish legislative based schemes of arrangement, almost two centuries ago, and diverse other jurisdictions have since sought to develop this

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<sup>41</sup> *BNY Corporate Trustee Services Ltd v Eurosail* [2013] UKSC 28.

<sup>42</sup> Ceri Morgan and Helen Laver, 'Case Comment: BNY Corporate Trustee Services Ltd and Ors v Neuberger Berman Europe Ltd and Anor [2013] UKSC 28' (UKSC Blog 16 July 2013) <<http://uksblog.com/case-comment-bny-corporate-trustee-services-limited-ors-v-neuberger-berman-europe-ltd-anor-2013-uksc-28/>> accessed 20 September 2019.

<sup>43</sup> *BTI 2014 LLC v Sequana S.A.* [2019] EWCA Civ 112. Also, see Radford Goodman, 'English Court of Appeal guidance on the clawback of dividends and directors' duties prior to insolvency: *BTI 2014 LLC v Sequana S.A.* [2019] EWCA Civ 112' (Norton Rose Fulbright 2019) <[https://www.nortonrosefulbright.com/-/media/files/nrf/nrfweb/knowledge-pdfs/us\\_15327\\_international-restructuring-newswire\\_summer2019-r5.pdf?la=en-za&revision=>](https://www.nortonrosefulbright.com/-/media/files/nrf/nrfweb/knowledge-pdfs/us_15327_international-restructuring-newswire_summer2019-r5.pdf?la=en-za&revision=>)> accessed 20 September 2019.



mechanism for their own use.<sup>44</sup> In the UK context, although the scheme of arrangement was originally created as a means of restructuring companies in financial distress, this legal mechanism is no longer employed simply as a solution to address debt issues but as the basis for company restructuring to accommodate changing business and consumer demands.

The UK model was originally created, developed and adapted for the specific needs of its society and corporate framework, situated within a particular national, historical and cultural foundation of laws and socio-political and economic practices. This thesis will point to the use of the schemes of arrangement as a flexible and efficient means of rearranging corporate affairs that will also address the weaknesses of the other restructuring mechanisms used in corporate law. In support of this proposition, it will be examined how the schemes of arrangement have been developed for use in a range of jurisdictions, some of which have historical or current links to the UK.

#### **1.4. The Development of the KSA Bankruptcy Law**

With effect from mid-February 2018, the KSA can be added to the global jurisdictions that have approved, established and implemented home-grown schemes of arrangement.<sup>45</sup> This development in the KSA law therefore brings a particularly pertinent comparative dimension to this discussion on evaluating the use of schemes of arrangement as a corporate restructuring tool, particularly since the KSA schemes of arrangement were created without having to compromise the *Shari'a* principles.

The KSA has been subjected to intense criticism over its strict adoption of *Shari'a* as the sole basis for the governance of its businesses and financial corporations, especially in the process of approving its membership of the World Trade Organization (WTO), the global network of trading standards, rules and practices, in 2005.<sup>46</sup> However, it is argued here that this criticism is

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<sup>44</sup> See Chapter III.

<sup>45</sup> Aly Khorshid, *Islamic Insurance: A Modern Approach to Islamic Banking* (Routledge 2015) 87-89.

<sup>46</sup> Steffen Hertog, *Princes, Brokers, and Bureaucrats: Oil and the State in Saudi Arabia* (Cornell University Press 2010) 241.

largely based on a lack of understanding of *Shari'a*.<sup>47</sup> Islam, however, represents an immutable part of the KSA's cultural ethos; it is an intrinsic part of the very infrastructure upon which this Islamic nation was founded.<sup>48</sup> *Shari'a* financial principles have proved themselves to be extremely robust, with the country emerging relatively unscathed from the financial crisis of 2008.<sup>49</sup> The KSA, therefore, has no justification for switching to an alternate structure that is non-*Shari'a* compliant.<sup>50</sup>

Recently, it has begun to greatly diversify its investments with a view to ending its sole reliance on its oil and gas sector and building a thriving new economy. In this context, the KSA new schemes of arrangement are likely to play an important role due to the increasing need for flexible and efficient mechanisms designed to assist with corporate planning and restructuring.

### **1.5. Restructuring Tools Available under Corporate Law**

Restructuring lies at the foundation for this study, be it in the form of internal corporate redesign, debt reformulation or scheme of arrangement, not to mention the huge array of tools which corporate law provides for reorganisational mechanisms. The term 'corporate restructuring' is used herein to refer to a contractual agreement that has been privately negotiated between a company and all or the majority of its creditors outside of an insolvency procedure. It will generally include the company stakeholders, for example employees, suppliers, investors, creditors and the government. The Finance Bill 2018 will move Her Majesty's Revenue and Customs (HMRC) up the ranking for asset distribution on insolvency, making the government a priority creditor, in the recovery of taxes due.<sup>51</sup> In scheme negotiations, the part played by the government in the restructure of debts poses a dilemma in responsibilities of the creditor, namely the potential conflict of principles of supporting

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<sup>47</sup> Edward Burton, *Business and Entrepreneurship in Saudi Arabia: Opportunities for Partnering and Investing in Emerging Businesses* (John Wiley and Sons 2016) 39.

<sup>48</sup> *ibid* 56-59.

<sup>49</sup> Oxford Business Group, *The Report: Saudi Arabia 2009* (Oxford Business Group 2009) 90.

<sup>50</sup> Burton (n 47) 56.

<sup>51</sup> HM Treasury, *Budget 2018: Protecting your taxes in insolvency* <[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/752136/Insolvency\\_web.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752136/Insolvency_web.pdf)> accessed 20 September 2019

recovery and ensuring taxpayer return. There is little basis for latter emphasis given that the principle of rescue is to facilitate the greater good of survival rather than more immediate partial gratification, so it is anticipated this change should not affect the negotiation of a scheme. Where negotiations are effective, restructuring may enable a company to bypass the formal process of insolvency and continue as a viable business entity. Alternatively, the members may engage in a formal process of insolvency as one of the steps required to engage in restructuring for survival.<sup>52</sup>

Restructuring is a mechanism for salvaging a business or corporation through debt reorganisation or schemes of arrangement whereby the entity exhibits a future promise of viability and profitability within the context of a highly competitive market.<sup>53</sup> Paterson repeatedly stresses the importance of a 'fair assessment', which involves the consideration, value assessment and pooling of the company's assets to evaluate viability of survival or insolvent settlement. In that context, it must undertake an examination of the causes of impending insolvency and indeed the potential need to fast-track an insolvency process, and the possible extension of a line of credit pending organisational and debt restructuring.<sup>54</sup> She argues that if a company shows strong promise and future financial assessment results are positive following this assessment, it should engage in restructuring. If not, it should be liquidated or, possibly, taken over by a larger corporation.<sup>55</sup>

It is the early identification of financial problems and impending potential distress that will enable directors to develop a scheme strategy to avoid insolvency procedures and the consequent intervention of an insolvency practitioner appointed by the court to examine and monitor debt management. In the case of a CVA, for example, there is still some loss of control over the conduct of the business by directors as secured creditors rights to enforce their charge

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<sup>52</sup> Michael Blatz, Karl Kraus and Sasha Haghani (eds), *Corporate Restructuring: Finance in Times of Crisis* (Springer Science & Business Media 2006).

<sup>53</sup> Sarah Paterson, 'Debt Restructuring and the Notion of Fairness' (Oxford Faculty of Law 28 June 2016) <<https://www.law.ox.ac.uk/business-law-blog/blog/2016/06/debt-restructuring-and-notions-fairness>> accessed 20 September 2019.

<sup>54</sup> *ibid.*

<sup>55</sup> *ibid.*

remain unaffected, as are those of preferential creditors, without their consents, as opposed to account being taken of the whole body of those owed by the company.<sup>56</sup>

The debtor-in-possession directors are nevertheless those who presided over financial decline which must raise questions of competency, but nevertheless 'insider knowledge' of the way the company works may be considered of broadly more value than the perspective of external intervention.<sup>57</sup> The governance rules apply to regulate conduct, but it will largely be incumbent on new financiers to ensure targets for stability improvement are met, certainly in the face of secured creditor resistance. The monitoring of scheme progress seeks to ensure reasonability and fairness where minority creditors find their interests prejudiced by more powerful interests, crammed down and subsequently lost ostensibly in the cause of rescue.<sup>58</sup>

The CVA has considerably less flexibility of purpose and operation and is only available when the company has hit the financial distress level. Insolvency procedures will often involve corporate restructure to meet rescue objectives but have fewer of the advantages of the schemes in company development and growth.<sup>59</sup>

### 1.5.1. Corporate Restructuring

Corporate restructuring should be triggered when a company cannot maintain its existing debt plan as agreed upon by creditors due to the absence of liquidity or an impending inability to

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<sup>56</sup> Lorraine Conway, 'Company Voluntary Arrangements (CVAs)' (House of Commons Briefing Paper Number 6944 11 June 2019) 7 <<https://researchbriefings.files.parliament.uk/documents/SN06944/SN06944.pdf>> accessed 20 September 2019.

<sup>57</sup> Robin E. Phelan and Eric D. Poole, 'Corporate Governance: Issues for the Financially Troubled Company' (Haynes and Boone LLP 2003) <<https://www.iiiglobal.org/sites/default/files/phelanandboone.pdf>> accessed 6 September 2019. Also, see European Law Institute (ELI), 'Rescue of Business in Insolvency Law', (ELI 2017) 163 <[https://www.europeanlawinstitute.eu/fileadmin/user\\_upload/p\\_eli/Publications/Instrument\\_INSOLVENCY.pdf](https://www.europeanlawinstitute.eu/fileadmin/user_upload/p_eli/Publications/Instrument_INSOLVENCY.pdf)> accessed 20 September 2019.

<sup>58</sup> The Insolvency Service, *Summary of Responses: A Review of the Corporate Insolvency Framework* (HMSO 2016) 9.

<sup>59</sup> Sarah Paterson, 'Reflections on Schemes of Arrangement and the Insolvency Service Consultation on the Corporate Rescue Framework' (Oxford Faculty of Law 2017) 1 <[https://www.law.ox.ac.uk/sites/files/oxlaw/paterson\\_schemes\\_of\\_arrangement.pdf](https://www.law.ox.ac.uk/sites/files/oxlaw/paterson_schemes_of_arrangement.pdf)> accessed 20 September 2019.

meet company financial obligations from capital or assets.<sup>60</sup> Commercial imperatives of maintaining competitiveness in a volatile market will require perhaps cyclical adaptive reorganisation as an astute exercise of management foresight to ensure stability. The company's directors arguably have a responsibility to promote restructuring as per section 172(1) of the CA 2006.<sup>61</sup> This requires that "a director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole".<sup>62</sup>

Creditors and members of the company may also make such a legally enforceable demand of its corporate officers to prove governance compliance and at least ultimate ability to continue trading. Section 172(3) of the CA 2006 imposes a duty on directors to take account and, where appropriate, act in accordance with creditors' interests, especially when insolvency looms. In the broad scope of the duty, however, Tsagas considers this an 'illusion' that they are protected, where actual enforcement is dependent on the multifarious considerations of the directors in the company's interests.<sup>63</sup> Within this context, restructuring involves realignment of the debt payment sums and the length of payment period with the reality of the company's financial position. Thus, restructuring may be defined as the execution of a new debt repayment schedule which will place the company in a better position to adhere to the new payment programme arrived at with a company's members and creditors.<sup>64</sup>

Crum and Goldberg further highlight that a set of distinct and decisive measures are employed to increase the competitiveness of a corporation and then enhance its value.<sup>65</sup> 'Restructure' here encompasses diverse business activities, including takeovers, mergers, acquisitions and amalgamations. All have played a significant role in the extrinsic growth of leading global

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<sup>60</sup> Rodrigo Olivares-Caminal and others, *Debt Restructuring* (Oxford University Press 2016) 7-8.

<sup>61</sup> *ibid* 7.

<sup>62</sup> Section 172(1), Companies Act 2006.

<sup>63</sup> Georgina Tsagas, 'Section 172 of the UK Companies Act 2006: Desperate Times Call for Soft Law Measures' (Oxford Business Blog 1 September 2017) <<https://www.law.ox.ac.uk/business-law-blog/blog/2017/09/section-172-uk-companies-act-2006-desperate-times-call-soft-law>> accessed 20 September 2019.

<sup>64</sup> Olivares-Caminal and others (n 60).

<sup>65</sup> Roy Crum and Itzhak Goldberg, *Restructuring and Managing the Enterprise in Transition* (World Bank Publications 1998).

conglomerates, including IBM, GlaxoSmithKline and Nestlé.<sup>66</sup> The practice of corporate restructuring has therefore become a universal practice in the business world, employed for bringing about growth, development and globalisation of corporations, times of opportunity as well as hardship and risk.<sup>67</sup>

It is however, when dealing with potential insolvency, used to facilitate the rescue of a business.<sup>68</sup> This may be achievable through reorganisation to trade out of difficulty rather than simply divide proportionately the remnants of failure.<sup>69</sup> The effectiveness of governance and supervision obligations come into play as partners of a successful reorganisation process. This becomes obviously and publicly transparent when the corporation has hidden its financial inadequacies so well behind a veil of regular restructuring that there is no hope of saving it, no matter its size and reach. This is reflected in the case of the UK's second largest building and facilities group Carillion in 2018, which was a product of ill-managed mergers and acquisitions beyond the control of effective management that was inadequately practised.<sup>70</sup> Travel giant Thomas Cook went into liquidation after attempting various schemes in recent years to restructure after expensive acquisitions which temporarily staved off demise, until its last ditch effort failed to attract the support of major creditors.<sup>71</sup> Liquidation could not be avoided.

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<sup>66</sup> Julian Birkinshaw, Alexander Zimmermann and Sebastian Raisch, 'How Do Firms Adapt to Discontinuous Change?' (2016) 58(4) *California Management Review* 36.

<sup>67</sup> John Humphrey, Raphael Kaplinsky and Prasad Saraph, *Corporate Restructuring: Crompton Greaves and the Challenge of Globalisation* (Sage 1998).

<sup>68</sup> Catherine Bridge, 'Insolvency – A Second Chance. Why Modern Insolvency Laws Seek to Promote Business Rescue' (2013) *Law in Transition* 28.

<sup>69</sup> Kristin van Zwieten, *Goode on Principles of Corporate Insolvency Law* (5<sup>th</sup> edn, Sweet and Maxwell 2019) 474.

<sup>70</sup> Matthew Vincent, 'Why Carillion Has Gone into Liquidation rather than Administration' (*Financial Times* 15 January 2018) <<https://www.ft.com/content/a4dd80be-f9f1-11e7-a492-2c9be7f3120a>> accessed 20 September 2019.

<sup>71</sup> Thomas Cook Group Plc, Thomas Cook Finance 2 Plc And Thomas Cook Group Treasury Limited, 'Scheme of Arrangement Proposal' (28 August 2019) <[https://www.thomascookgroup.com/investors/insight\\_external\\_assest/ThomasCook-PracticeStatementLetterPSL-August2019.pdf](https://www.thomascookgroup.com/investors/insight_external_assest/ThomasCook-PracticeStatementLetterPSL-August2019.pdf)> accessed 20 September 2019. Also, see Robert Moore, 'Thomas Cook in Liquidation' (*Company Rescue* 23 September 2019) <<https://www.companyrescue.co.uk/guides-knowledge/news/thomas-cook-in-liquidation-4384/>> accessed 20 September 2019.

### 1.5.2. Restructuring and Reconstruction

Corporate restructuring is a complex process which has, as its aim, to have an effect on at least three broad sectors of the company (i) financial, (ii) asset preservation or sale and (iii) organisational reorientation.<sup>72</sup> Financial restructuring refers to stock repurchases, leveraged buyouts and recapitalisations.<sup>73</sup> Asset restructuring involves the spin-off or selling of a business within a company's portfolio with the aim of re-focusing the diversification level if this is low. Finally, organisational restructuring involves changing and refining the operations set-up within the company; it is not generally concerned with either disposal or sale of assets.<sup>74</sup>

Corporate reconstruction may therefore be considered the process by which a company or a collection of companies is converted or transferred to a new business entity. It is likely to be a feature of an effective rescue of the business as a whole or its constituent parts.<sup>75</sup> The most significant legal issue of the restructure is to ensure that the interests of all stakeholders are protected throughout the process, not simply those who stand to gain the most from the procedure.<sup>76</sup> Types of reconstruction include merger by formation, the dissolution of the assets and liabilities of one company and transfer of the same to new entity<sup>77</sup> or acquisition, where two or more companies join forces;<sup>78</sup> the type is dependent upon the objective of the reconstruction. The incorporation of the cross-border merger regulations into the EU Consolidated Company Law Directive 2017/1132 facilitates, amongst member states, improved protection for creditors, as per Article 121(2), and minority shareholders.<sup>79</sup>

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<sup>72</sup> Philip Gibbs, 'Determinants of Corporate Restructuring: The Relative Importance of Corporate Governance, Takeover Threat and Free Cash Flow' (1993) 14(S1) *Strategic Management* 51.

<sup>73</sup> John Kose, Larry Lang and Jeffry Netter, 'The Voluntary Restructuring of Large Firms in Response to Performance Decline' (1992) 47(3) *Journal of Finance* 891.

<sup>74</sup> Magdy Abdel-Kader and Vagia Mentzeniot, 'Corporate Sell-offs and the Use of the Proceeds: The Case of GEC/Marconi Restructuring' (2007) 1(1) *World Journal of Business and Management* 28.

<sup>75</sup> John Paul Tribe, 'Companies Act Schemes of Arrangement and Rescue: The Lost Cousin of Restructuring Practice?' (2009) *Butterworths Journal of International Banking and Financial Law* 1, 4 <[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1328487](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1328487)> accessed 20 September 2019.

<sup>76</sup> Sarah Paterson *et al* *Debt Restructuring* (Oxford University Press 2011) 11-12.

<sup>77</sup> Directive 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law [2017] OJ L169/46, art 86.

<sup>78</sup> *ibid* art 4.

<sup>79</sup> Vanessa Knapp, 'Cross-Border Mobility: What Do We Need in Practice?' (2018) 19(1) *ERA Forum* 63.

It is noted that a particular effect of the merger by formation option is that the shareholders of the former business will be issued with equivalent shares in the new company instead of receiving repayment of their liquidated capital from the old company. Reconstruction of this type often involves a takeover, the establishment of a fresh management team and the sacking of the entrepreneur; these actions are done in the hope of recovering all or some of the investment at a later date.<sup>80</sup> There may actually be commercial arguments for demerging unwieldy or now unnecessary parts of the company business strategy to operate separately or selling them on as part of a rationalisation programme.

### 1.5.3. Corporate Protection and Rescue

The notion of rescuing a business by recycling its assets to return them back to productivity and a level of value that may allow further lending has recently become an important point in business preservation and value to its broader stakeholder body.<sup>81</sup> This is an important factor in delivering the objectives of the restructuring as it aims to provide the basis for funding the short to medium term reorganisation plans of a company, thereby limiting the need for investment and further risk. It must be emphasised that the selection of the form of restructuring and configuration is important since the aim of the restructuring is to attain a synergy between business needs, shareholder value and creditor-stakeholder entitlements.<sup>82</sup> The central principle observed when buying a commercial entity in the process of reorganisation is to enhance its attraction to stakeholders. Essentially, the value of a collaborative configuration following merger or acquisition should be more than the worth of a demarcated configuration of the two corporations individually.<sup>83</sup> Corporate restructuring has

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<sup>80</sup> Anders Isaksson, 'Exit Strategy and the Intensity of Exit-directed Activities' in Greg N Gregoriu, Maher Kouli and Roman Kraeussl, *Venture Capital in Europe* (Elsevier 2011) 143.

<sup>81</sup> Paul J Omar and Jennifer Gant, 'Corporate Rescue in the United Kingdom: Past, Present and Future Reforms' (2016) 24(1) *Insolvency Law Journal* 40.

<sup>82</sup> Linda Roussel, *Management and Leadership for Nurse Administrators* (Jones & Bartlett Learning 2012) 280.

<sup>83</sup> Donald DePamphilis, *Mergers, Acquisitions, and Other Restructuring Activities* (Academic Press 2010).



therefore been a crucial instrument for commerce, particularly in the European and American economies, for the past two decades.<sup>84</sup>

#### 1.5.4. *The Phoenix Syndrome*

Where the company is no longer a viable entity but the business remains feasible, the latter can survive as a broadly identical undertaking or corporation under a different company name. It is no so much a corporate rescue but a preservation of a business which can continue to meet the imperatives of securing employment and the interests of parties in the supply chain, albeit at the expense of the creditors of the demised company entity. It is a practice which is normally considered as an administration process in the selling off of assets, but it is considered in this context as an alternative survival mechanism. Whilst it may not affect the rescue of the company, the business survives intact, potentially achieving a similar result for stakeholders.

The company dies but its undertaking, along with its assets and liabilities, is transferred to another entity which largely consists of the same shareholders, with the view that the operations being continued by the transferee organisation.<sup>85</sup> The same stockholders of the new entity may have a majority share but less than half of the value in relation to their holdings in the former company, now terminated and owned by the recipient new undertaking, set up especially for that purpose, with a view to continuing trading.<sup>86</sup>

Historically, this type of transfer arrangement was disapproved of in some quarters because of the risk of the so-called 'phoenix syndrome' whereby a company might rise from the ashes of its failed forerunner<sup>87</sup> even though the second company's business and those controlling it are essentially the same. Although phoenix activity can be legal,<sup>88</sup> this form of restructure was often undertaken in the UK, businesses having incurred considerable financial unsecured

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<sup>84</sup> Robert Hoskisson and others, 'Diversified Business Groups and Corporate Refocusing in Emerging Economies' (2005) 31(6) *Journal of Management* 941.

<sup>85</sup> *ibid* 148-149.

<sup>86</sup> Evelyn Ford, *Taxation of Company Reorganisations in Ireland* (A&C Black 2011).

<sup>87</sup> Helen Anderson and others, 'Quantifying Phoenix Activity: Incidence, Cost, Enforcement' (University of Melbourne, Legal Studies Research Paper October 2015).

<sup>88</sup> *ibid*.

obligations, to facilitate escape from creditors by liquidation, then rising to trade again under a moderately amended name. One way of mitigating this risk to creditors is through the legal prohibition that once a company has entered insolvent liquidation, the directors of that company are not permitted to form or manage a business under the same or a similar name.<sup>89</sup> As part of a restructuring scheme that is monitored and approved by the court, and potentially conducted as part of an administrative prepack which advances the company and retains the benefits to society in terms of jobs, the phoenix may indeed prove to be a socially and commercially advantageous step.<sup>90</sup>

#### 1.5.5. *Schemes of Arrangement and Chapter 11 of the US Bankruptcy Code*

Paterson highlights the integral importance of a lawful adaptation to risk capacity in commercial functioning, and considers the extent to which the UK tendency towards schemes of arrangement and restructuring leads to more desirable outcomes than the prevalent practice in the US for filing for Chapter 11 US Bankruptcy Code (USBC) ‘protection from creditors’.<sup>91</sup> This facilitates the reorganising of debt, filing of plans for continuation of the business, or declaring bankruptcy.<sup>92</sup> The principal reason why UK companies tend towards restructuring is that the courts afford creditors and members the opportunity to decide their preferred course of action, without exercising governing intervention. Paterson highlights the contrasting principle of the benign UK court oversight, which is less litigious in nature and thus less costly for dissenting interests, with the concerted ‘interventionist stance’ adopted by US law.<sup>93</sup>

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<sup>89</sup> The Insolvency Service, ‘2016 Guide to Liquidation (Winding-up) for Directors’ <<https://www.gov.uk/government/publications/guide-to-liquidation-winding-up-for-directors/guide-to-liquidation-winding-up-for-directors#reusing-the-company-name-after-insolvent-liquidation>> accessed 20 September 2019.

<sup>90</sup> White and Case, ‘Insight: Financial Restructuring and Insolvency’ (White and Case April 2011) 1 <[https://www.whitecase.com/sites/default/files/files/download/publications/alert\\_schemes\\_of\\_arrangement\\_hot\\_topics\\_market\\_trends.pdf](https://www.whitecase.com/sites/default/files/files/download/publications/alert_schemes_of_arrangement_hot_topics_market_trends.pdf)> accessed 20 September 2019.

<sup>91</sup> Sarah Paterson, *Insolvency Law, Restructuring Law and Modern Financial Markets* (Slaughter and May 2015) 2.

<sup>92</sup> United States Courts, ‘Chapter 11 - Bankruptcy Basics’ <<https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics>> accessed 20 September 2019.

<sup>93</sup> Paterson (n 91) 2.

Although the financial background and views of the involved parties should ultimately determine the adoption of insolvency strategies or the filing for Chapter 11 Protection, the US offers companies, including many of its largest corporations, a limited choice of action or result in these circumstances. Simply, they must merge, engage in a takeover or declare insolvency. Paterson is highly critical of this approach, noting how this led to the disruption and failure of the entire US automobile industry by the mid-2000s. She emphasises that resorting to Chapter 11 negatively impacts upon the economy because it does not allow insolvent or financially ailing companies to voluntarily engage in restructuring, which could potentially give them a new lease of life. It ignores the potential for the re-emergence of a particular market and the possibility of producing profits and jobs, and injecting new money into the economy.<sup>94</sup>

#### 1.5.6. UK Courts Recognition of USBC Chapters 11 and 15 Orders

Given the prominence of the US in the global markets, there is a need for recognition of the legitimacy of corporate restructure undertaken within the legal framework of other nations. This has to include the recognition and enforcement of the changes of obligations to ensure continuation of commercial viability in the world's largest trade forum. Foreign companies may gain access to the American procedures for the protection and distribution of corporate assets in the US in the context of bankruptcy in another country under Chapter 15 USBC.<sup>95</sup>

Jurisdictional qualifications must of course be satisfied. Berkoff notes this hurdle may be met simply by "assets in the United States in the form of a retainer for U.S. counsel, and the primary Indenture sought to be impacted by the scheme of arrangement was governed by New York law".<sup>96</sup> This was the somewhat tenuous relationship with the jurisdiction utilised in the case of *Avanti Communications*.<sup>97</sup> This facilitates the recognition of the schemes of arrangement developed under the laws of other nations insofar as they affect the dealings with assets in the

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<sup>94</sup> *ibid.*

<sup>95</sup> US Bankruptcy Code Chapter 15: Ancillary and Other Cross Border Cases (Sections 1501 to 1532).

<sup>96</sup> Leslie Berkoff, 'United States: Drawing the Borders on Chapter 15 Bankruptcy' (Moritt, Hock & Hamroff LLP 27 September 2018)

<<http://www.mondaq.com/unitedstates/x/740060/Insolvency+Bankruptcy/Drawing+The+Borders+On+Chapter+15+Bankruptcy>> accessed 20 September 2019.

<sup>97</sup> *Avanti Communications Group Plc* [2018] 582 BR 603 (United States Bankruptcy Court, SD New York).

American jurisdiction. Further consideration is therefore pertinent to the section 1520 “effects of recognition of a foreign main proceeding”<sup>98</sup> as exemplified in the UK statement of arrangement case of *Avanti Communications*.

Avanti was a satellite communications company registered in the highly competitive UK market. It faced financial demise and so was undertaking a scheme of arrangement debt restructure in the UK in an attempt to re-establish commercial and market viability. The scheme received strong support from shareholders and creditors, but required release from obligations by third parties not directly involved in, but affected by, the reorganisation.<sup>99</sup> The English High Court termed such parties as ‘non-debtor affiliate-guarantors’. Release from such ancillary obligations are problematic in the US where courts have been faced with the difficulty of deciding whether bankruptcy courts can in fact grant such releases, and if so when. Some of these courts have decided that only releases against a debtor are allowed by the USBC and that third-party releases absent consent are prohibited.<sup>100</sup> Given the order of the UK courts, recognition and enforcement was afforded to the release provisions “the exercise of comity [including] recognising and enforcing a foreign plan confirmation order”.<sup>101</sup>

The UK allows those who have a detailed knowledge of the company and its potential for future profitability and market performance to decide whether or not debt restructuring might provide a more preferable option on the basis of the long-term potential of market re-emergence, strength and the generation of new capital.<sup>102</sup> Control is retained by existing directors in the UK scheme, where appropriate, which arguably retains expertise and

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<sup>98</sup> US Bankruptcy Code, ‘Chapter 15 – Ancillary and Other Cross Border Cases (Sections 1501 to 1532) > Subchapter III – Recognition of a Foreign Proceeding and Relief’ <<https://www.usbankruptcycode.org/chapter-15-ancillary-and-other-cross-border-cases/subchapter-iii-recognition-of-a-foreign-proceeding-and-relief/>> accessed 20 September 2019.

<sup>99</sup> Shantel Watters-Rogers, ‘Bankruptcy Court Enforces Non-consensual Third Party Releases in Chapter 15 Case’ (Norton Rose Fulbright 16 July 2018) <<http://www.nortonrosefulbright.com/knowledge/publications/169167/bankruptcy-court-enforces-non-consensual-third-party-releases-in-chapter-15-case>> accessed 20 September 2019.

<sup>100</sup> *Avanti Communications Group* (n 97).

<sup>101</sup> Daniel Lowenthal, ‘Chapter 15: US Court Respects UK Scheme of Arrangement: Third-Party Releases Enforce’ (Patterson Bellknap Webb and Tyler LLP 5 June 2018) <<https://www.lexology.com/library/detail.aspx?g=844cf99b-0a20-4099-8547-89f1809208d9>> accessed 20 September 2019.

<sup>102</sup> Paterson (n 91) 2.

knowledge pertinent to the continuation of the company. This is likely to be more appealing in the protection of stakeholder and creditor interests in the longer term than picking at the bones of a potentially viable but now defunct company through the Chapter 11 appointment of executors. This *prima facie* makes corporate restructuring more pragmatic and economically sensible than the US option of Chapter 11 Protection from, and exclusion of, creditors.

Foreign companies appear to have some advantage in maintaining control over the management of restructuring in circumstances of financial distress in the use of its domestic legislation, where it exists, even when they, for example, have considerable assets and liabilities in America. However, whilst the flexibility of purpose of foreign schemes is invaluable to corporations, it should not be presumed, as a tactical practice, that acceptance in the US will be automatic. Lawton and Wolf warn that “the flexibility and variability of schemes (valuable attributes) belie the assumption that recognition of schemes under Chapter 15 is a one-size-fits-all judicial inquiry” especially in the face of opposition.<sup>103</sup>

### **1.6. Traditional Restructuring**

When a company requires restructuring, one of the core concerns is ensuring that there is a degree of fairness for all the parties involved in a company’s operations, from shareholders to creditors.<sup>104</sup> Restructure plans and mechanisms must create a legal framework which protects shareholder investment in their company, balanced against the interests of creditors who want their debts repaid, thus ensuring that liabilities to the company are minimised in the short to medium term.<sup>105</sup>

It has been noted that, traditionally, corporations have used two core mechanisms as the basis for restructuring their operations and obligations. In the merger and acquisition process, the

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<sup>103</sup> David L Lawton and Shannon B Wolf, ‘The Thing about Schemes in the Scheme of Things: Recognition of Schemes of Arrangement under Chapter 15 of the U.S. Bankruptcy Code’ (INSOL International Technical Series Issue No 38 March 2018) 2 <<https://bracewell.com/sites/default/files/news-files/INSOL%20International%20-%20Technical%20Paper%20-%20Lawton.pdf>> accessed 20 September 2019.

<sup>104</sup> Sarah Paterson, ‘Debt Restructuring and Notions of Fairness’ (2017) 80(4) *Modern Law Review* 600, 610-611.

<sup>105</sup> Sarah Paterson, ‘Rethinking Corporate Bankruptcy Theory in the Twenty-First Century’ (2016) 36(4) *Oxford Journal of Legal Studies* 697, 704.

acquiring company, in this deliberate and organised transfer of control and ownership, assumes all of the assets and liabilities of the other company.<sup>106</sup> Generally, smaller entities are subsumed, or businesses come together to create a stronger, more efficient body to jointly conduct their commercial activities in a complementary manner, 'vertically', operating within the same supply chain, or 'horizontally', companies operating at the same level in different market areas.<sup>107</sup>

The EU Mergers Directive<sup>108</sup> supports similar types of merger processes under (i) Article 3 by formation, in so doing creating a new company to restructure operations, and (ii) by acquisition, where the new company's operations are more effectively executed by acquiring other businesses, as per Article 4.<sup>109</sup> Title II Company Law Directive (EU) 2017/1132 amends and updates the Mergers Directive for the protection of often competing interests of shareholders, creditors and employees in public limited companies subjected to a restructuring process.<sup>110</sup>

The reasons for a merger or acquisition vary, from security of operations to expansion. It may be aimed at the protection of a company's financial position through merging with a similar company in a stronger fiscal state or utilised to create greater wealth within the companies by combining assets to generate greater efficiency within their marketplace, ultimately delivering greater shareholder wealth.<sup>111</sup> A pertinent example of the latter focus of expansion for more dynamic market competitiveness is the case of the Time-Warner merger. In the 1990s, Warner Communications, a film and TV company, merged with Time, a highly respected politico-economic magazine. The newly merged company renamed Time Warner, Inc. was considerably stronger than the two separate component entities, and used its power in the market to

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<sup>106</sup> Patrick Gaughan, *Mergers, Acquisitions and Corporate Restructuring* (John Wiley and Sons 2015) 19-22.

<sup>107</sup> DePamphillis (n 83) 17-19.

<sup>108</sup> Directive 2009/133/EC of the Council of the European Union of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States.

<sup>109</sup> Yonathan A Arbel, *Study on the Application of the Cross-Border Merger Directives* (Bech-Braun 2013) 106.

<sup>110</sup> Directive 2017/1132 (n 77).

<sup>111</sup> Rajinder Aurora and Kavita Shetty, *Mergers and Acquisitions* (Oxford University Press 2011) 32-33.

acquire other brands such as DC Comics, CNN, Time Warner Cable amongst others.<sup>112</sup> A combination of hostile takeovers and non-hostile mergers was used to strategically place the company at the forefront of the entertainment and news market. Mergers and acquisition can be highly effective alternative mechanisms to restructuring, but can also be extremely time-consuming and costly, attracting considerable legal scrutiny to protect competition in the market.<sup>113</sup>

The reasons for this type of corporate restructuring will include financial or debt reorganisation, or a desire to create greater efficiencies by combining company operations. These issues are commonly dealt with by director planned schemes which are monitored by courts. Mergers, acquisitions and takeovers are more closely regulated by statute and, as a result, are often very time-consuming and costly in terms of achieving compliance.<sup>114</sup> The alternative scheme of arrangement, where there is a lack of resistance to the joinder, appears more efficient in terms of cost and less time-consuming.

### **1.7. Modern Schemes of Arrangement**

Schemes of arrangement, as a bespoke, self-negotiated corporate plan, have a long history in the UK and their origins can be traced back to the Companies Act 1862.<sup>115</sup> Early formulations of schemes of arrangement were quite rigid and primarily used as a mechanism to allow a company on the verge of insolvency or already insolvent to put a plan to its creditors to allow for the restructuring of the company.<sup>116</sup> This meant that schemes of arrangement effectively served as a last resort for companies in serious financial difficulty attempting to avoid insolvency. A scheme was akin to a contract between the company and its creditor-stakeholders and generally involved putting a proposal about the company's future structure

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<sup>112</sup> Alec Klein, *Stealing Time: Steve Case, Jerry Levin, and the Collapse of AOL Time-Warner* (Simon and Schuster 2014) 67-69.

<sup>113</sup> Christopher S Harrison, *Make the Deal: Negotiating Mergers and Acquisitions* (Wiley 2013).

<sup>114</sup> John Coates, 'Mergers, Acquisitions and Restructuring: Types, Regulation, and Patterns of Practice' In JN Gordon and WG Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (Oxford University Press 2018) 4-5.

<sup>115</sup> Geoff O'Dea, Julian Long and Alexandra Smyth, *Schemes of Arrangement: Law and Practice* (Oxford University Press 2012) 12-13.

<sup>116</sup> Kanaga Dharmananda and Anthony Papamatheos, *Schemes of Arrangement* (Federation Press 2011) 22-23.

and legal ownership to the company's creditors who then voted whether to accept or reject this.<sup>117</sup> A minimum of 75% of creditor approval was required for any scheme to be deemed lawful given the potential for substantial alteration of the legal effect of liabilities.<sup>118</sup>

In more recent decades, however, there has been a willingness to expand the availability of schemes of arrangement to circumstances other than financial difficulty.<sup>119</sup> They have become a means by which companies can propose new structures and ways of conducting business to their stakeholders which reorganises corporate practices or composition. It may simply be a formal approval a structural change which may already have the support of stakeholders. As such, and given the inherent flexibility of their operation, schemes of arrangement are now viewed as an alternative to the other restructuring mechanisms such as mergers and acquisitions or takeovers. The discussion and analysis in this thesis focuses on non-insolvency corporate restructuring mechanisms. However, it draws upon corporate insolvency restructuring mechanisms to evaluate whether reorganisational aims can best be fulfilled by relying on the more flexible schemes of arrangement to achieve business objectives rather than having recourse to the other means.

### **1.8. Legal Transplantation**

One of the core issues considered in this study is whether debt restructuring processes and schemes of arrangement to accommodate corporate change, as practised in the UK, can be transplanted into the legal frameworks of other jurisdictions and countries. It is a question of feasibility which is imbued with national, cultural, socio-economic and interactive legal considerations.<sup>120</sup> Siems argues that this is perfectly possible since the overwhelming majority of legal systems have successfully incorporated ideas from other parts of the world.<sup>121</sup> This is particularly true in respect to the limited liability company. It will be noted in Chapter III, which

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<sup>117</sup> *ibid.*

<sup>118</sup> Section 899 of the CA 2006. Also, see Christian Pilkington, *Schemes of Arrangement in Corporate Structuring* (Sweet and Maxwell 2013) 8-10.

<sup>119</sup> Payne (n 14) 4-8.

<sup>120</sup> Mathias Siems, 'Malicious Legal Transplants' (2018) 38 *Legal Studies* 103.

<sup>121</sup> *ibid* 109.



reviews schemes of arrangement in a range of countries, that a regional scheme of arrangement or debt restructuring is viable and, indeed, some former British colonies and current members of the Commonwealth have adopted schemes of arrangement which are similar to those used in the UK. Nevertheless, even though there may be numerous similarities of such processes in the examined nations, this does not constitute a case of direct legal transplantation.

The structure of companies, their needs and the interests of both shareholders and creditors are ubiquitous and shared across the world. This undermines Legrand's argument that 'transplantation', which is how the adoption of best available practice is termed, cannot work in different countries or cultures.<sup>122</sup> In the formulation of a framework of law which is novel to a jurisdiction, it appears that a logical step for legislators is to look to the experiences of more mature systems and from there borrow ideas.<sup>123</sup> Indeed, in common law jurisdictions such as the UK and in international law where model codes are frequently adopted, the courts will look to foreign national adjudications for reference where there is no precedent principle of law on an issue before it.<sup>124</sup> Indeed, Siems notes that western laws, even beyond the subject of corporate practices, have been copied into other national jurisdictions since colonial times.<sup>125</sup> However, ultimately all jurisdictions possess their own unique socio-economic and politico-legal character and this has to be reflected in their mechanisms for corporate and debt restructuring, including schemes of arrangement. Cross-fertilisation of law has advantages in establishing principles for legal systems as they adapt to new needs and politico-economic market demands, but sight must not be lost of the traditions into which transplantation occurs.

This study will examine the new Bankruptcy Law of the KSA, an integral part of its Vision 2030 initiative reform, and the extent to which the corporate needs of restructure are accommodated through consultation with, and guidance from, international bodies, adapting

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<sup>122</sup> Pierre Legrand, 'The Impossibility of "Legal Transplants"' (1997) 4(2) *Maastricht Journal of European and Comparative Law* 111, 112.

<sup>123</sup> Alan Watson, *Comparative Law: Law, Society & Reality* (Vandeplas 2007) 5.

<sup>124</sup> Gilbert Guillaume, 'The Use of Precedent by International Judges and Arbitrators' (2011) 2(1) *Journal of International Dispute Settlement* 5.

<sup>125</sup> Mathias Siems, *Comparative Law* (2<sup>nd</sup> edn, Cambridge University Press 2018) 251-255.

working practices to traditional principles. There has been some considerable wisdom in the adoption of the consultative approach undertaken by the KSA as it overhauled outdated corporate laws and procedures. One of the benefits of transplantation, as Siems points out, is familiarity, i.e. that firms in the recipient jurisdiction will be able to do business more easily with firms from the transplant country because of their shared laws.<sup>126</sup> This is one of the primary concerns of the KSA government acutely conscious of excessive dependence on a single, finite source of economic wealth.

### *1.8.1. Transplantation and Adjustment to National Norms*

Legrand's opinion on transplantation of legal principles is that "Law is mainly an outgrowth of local society. Law is embedded holistically in local culture. This makes reception and assimilation of foreign ideas problematic".<sup>127</sup> This, it is suggested, may be more of a pertinent argument in culturally sensitive practices, and certainly in the case of Islamic frameworks, such as that of Saudi Arabia, that feature strict financial religious tenets. It is a somewhat less significant problem with company law given the global nature of practices and principles. The degree of similarity between schemes of arrangement implemented by the nations studied herein does suggest that relatively minor adjustment to practice and principle gives rise to the potential for transplant compatibility. While UK schemes of arrangement cannot logically be directly transplanted to a different national socio-economic legal framework, they can be redesigned to improve compatibility with existing corporate law and practices in other jurisdictions.

Transplantation of laws from another jurisdiction is generally not best practice due to major differences concerning how problems of insolvency and debt restructuring are economically and socially perceived and whether a distressed company has the potential for profit, market competitiveness and viability. In the US, for example, the preference is to file for Chapter 11

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<sup>126</sup> Siems (n 120).

<sup>127</sup> Warwick Twining, 'Diffusion of Law: A Global Prospective' (2004) 49 *Journal of Legal Pluralism and Unofficial Law* 1, 28.

and declare bankruptcy<sup>128</sup>, then seek to restructure the organisation for greater profitability, market competitiveness or to consider a merger.

A national context of governmental tolerance of corrupt business practices, especially in developing economic frameworks, will militate against the effectiveness of the legal transplantation and rules which appear inconvenient to interested parties.<sup>129</sup> In many such countries, particularly Russia, large corporations were previously part of a public sector which dwarfed private enterprise and they continually operated without prospect of accounts based profitability, carrying massive corporate debt. These companies were never held to account for persistent failure to repay the creditor, generally the state owned bank, so there is no incentive to adopt formal, legal corporate restructuring mechanisms or to enter into firm and binding credit agreements.<sup>130</sup> The enormous financial losses suffered by these companies, or indeed unaccountable gains, and the absence of any pressure to adhere to creditor agreements greatly enriched their senior executives. In those cases when these public-sector companies were finally sold as a result of ever-increasing public and media pressure, they were frequently sold off for a pittance to pay creditors and, all too often, bribery was the real driver of the valuation of these companies.<sup>131</sup>

Within such a framework, there is no pressing reason for the developing countries to engage in the legal transplantation of restructuring mechanisms particular to the UK and other countries considered herein. It would arguably operate against the private economic and political interests of those at the helm who, in reality, outranked the governor of the national bank in these countries.<sup>132</sup> In fact, the reason for doing so would generally be considered nefarious, even malicious, designed to further the interests of the corrupt governmental elite. Transplants of legal principles have little legitimacy or value where the recipient country is not ideologically

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<sup>128</sup> Paterson (n 91) 3.

<sup>129</sup> Julia Gray, *The Company States Keep: International Economic Organisations and Investor Perceptions* (Cambridge University Press 2013) 94-96.

<sup>130</sup> *ibid* 95.

<sup>131</sup> *ibid* 95-97.

<sup>132</sup> *ibid* 101-102.

and psychologically compatible with the source.<sup>133</sup> Mattei and Nader suggest that in countries with endemic corruption, western laws which protect property militate against the interests of the less advantaged and poor, and indeed prove counterproductive to economic development and the protection of private enterprise.<sup>134</sup> Indeed it may be argued that the transplantation of the protective machinery and judicial oversight of schemes of arrangement principles would simply entrench the benefits of corruption. It would constitute an underlying maliciousness of purpose which in turn, it is suggested, would undermine the credibility, comity and recognition imperatives of international jurisdictions. Laws must be tailored to align with the realities of specific politico-economic and socio-cultural environments if they are to retain their utility and overcome the malicious intent of vested interests. This, however, presumes there is a public will and capacity to limit and resist governmental actions and motives.<sup>135</sup>

### 1.8.2. *The KSA Experience of Transplantation*

McCloskey notes that good ideas have been a source of good practices and these accrue economic benefits, and whilst these ideas may be of foreign origin, there is little to suggest that intellectual isolation provides comparative returns to the state.<sup>136</sup> Unless efforts are made to realign the mechanisms of schemes of arrangement which are globally prevalent with the predominant financial operations in other countries, their transplantation will be, at least, unsuccessful.<sup>137</sup> Following the lead of the KSA, several Islamic countries have adopted Islamic based financial systems which deal with approaches to debt, debt restructuring, corporate reorganisation and even expanded areas and markets for investment whilst explicitly excluding others.<sup>138</sup> The Islamic legal framework has proved effective in Malaysia and Indonesia, and indeed banks and financial institutions in Western countries have created their own Islamic finance divisions, suggesting secular trust in the system to produce consumer attraction from

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<sup>133</sup> Siems (n 120) 110.

<sup>134</sup> Ugo Mattei and Laura Nader, *Plunder: When the Rule of Law is Illegal* (Wiley-Blackwell 2008).

<sup>135</sup> Siems (n 86) 117.

<sup>136</sup> Deirdre N McCloskey, *Bourgeois Equality: Ideas, not Capital or Institutions, Enriched the World* (University of Chicago Press 2016).

<sup>137</sup> Aamir A Rehman, *Gulf Capital and Islamic Finance: The Rise of New Global Players* (McGraw-Hill 2010) 241.

<sup>138</sup> *ibid* 242-243.

their successful Muslim business communities.<sup>139</sup> Moreover, those countries employing *Shari'a*-compliant practices cannot see any economic or financial reasons to discard the current mechanisms they employ in favour of the scheme of arrangement as used in countries such as the UK. A worthy example of Quranic teaching is, for example verse 2:280, commonly translated as, “if a person is in difficulty, let there be respite until a time of ease, and if you forgive the debt voluntarily it would be better for you”. Al-Bashir and Al-Amine stresses that Islamic law compels a debtor to repay his obligations on time and that it is a sin, not simply a breach of contract law, to fail to do so; the caveat is inserted “if the debtor has the capacity to repay”.<sup>140</sup>

The KSA, and other nations which incorporate Islamic financial arrangements and practices, are unlikely to make compromises to attain greater alignment with western concepts of debt and organisational restructuring. These are private compromises will have to be made by the involved parties or not at all.<sup>141</sup> It may be argued that most countries will consider entering into agreements which make concessions to vibrant and goal orientated Islamic finance principles which have proved successful and stabilising in Malaysia and Indonesia, for example.<sup>142</sup> Nevertheless, direct legal transplanted of schemes of arrangement is simply not an option. Extensive negotiations may lead to the successful establishment of a global scheme of arrangement regime, but its particulars will be determined by the politico-economic, market dynamics and socio-cultural characters of the nations in question.

### **1.9. Problem Analysis**

The primary issue under investigation in this research is whether a scheme of arrangement can be employed in instances when the other restructuring mechanisms have proved inefficient. This research identifies, explains and evaluates a range of schemes of arrangement from

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<sup>139</sup> *ibid* 242-243.

<sup>140</sup> Muhammad Al-Bashir and Muhammad Al-Amine, ‘Insolvency and Restructuring in Islamic Finance’ (Harvard-LSE Workshop on Insolvency & Debt Restructuring in Islamic Finance 28 February 2013) <[http://irep.iium.edu.my/30475/1/Harvard-LSE\\_Workshop\\_Comments\\_Feb23.pdf](http://irep.iium.edu.my/30475/1/Harvard-LSE_Workshop_Comments_Feb23.pdf)> accessed 20 September 2019.

<sup>141</sup> Rehman (n 137) 242-244.

<sup>142</sup> *ibid* 244-245.

different jurisdictions in order to determine the extent to which they can serve as a flexible and efficient means of reorganising companies in the cases of failure of existing procedures. The other forms of restructuring experienced a spike in 2016 as global corporations turned their expansion and investment interest to the Continent.<sup>143</sup>

The US continues to exhibit its long-standing preference for mergers, acquisitions and takeovers, often of a hostile nature.<sup>144</sup> These activities eliminate the competitor and utilise the consumer base and production capacity of the weaker partner, occasionally aiding the addition of new service provisions to the parent's portfolio.<sup>145</sup> Given that the scheme of arrangement is generally implemented by a financially weak corporation, it would require cooperation of the parties to the M&A transaction, the exclusion of hostile action from the stronger partner and arguably an increase in the synergy for success in the new joint corporation.<sup>146</sup> A similar preference to that of the US process is embedded in the markets of EU members and associate trading partners such as Belgium, Germany, France, the Republic of Ireland<sup>147</sup> and Switzerland.<sup>148</sup> Simply expressed, all forms of restructuring are considered and even utilised in the shifting global market but the processes historically and traditionally adopted as companies adjust to changing times remain most popular, albeit by a tight margin in some cases.<sup>149</sup>

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<sup>143</sup> Ezra Davids and others, 'The Laws Governing M&A Activity in Africa' (*Bowmans Law*, January 2017) 6-8 <[http://www.bowmanslaw.com/wp-content/uploads/2017/01/Legal-Week\\_Global-MA-Guide-2017.pdf](http://www.bowmanslaw.com/wp-content/uploads/2017/01/Legal-Week_Global-MA-Guide-2017.pdf)> accessed 17 February 2018.

<sup>144</sup> John VM Gibson, *How to Buy A Business Without Being Had* (Page Publishing 2017) 97-102.

<sup>145</sup> Erik Yang and Samim Zarin, 'Mergers and Acquisitions - Hostile Takeovers and Defense Strategies against them' (University of Gothenburg 2011) 10 <[https://gupea.ub.gu.se/bitstream/2077/28242/1/gupea\\_2077\\_28242\\_1.pdf](https://gupea.ub.gu.se/bitstream/2077/28242/1/gupea_2077_28242_1.pdf)> accessed 20 September 2019.

<sup>146</sup> Michael Gajic and Michael Scarf, 'Takeover Bid v Scheme of Arrangement - Structuring a Friendly Acquisition' (Minter Ellison) <<https://www.minterellison.com/articles/takeover-bid-v-scheme-of-arrangement-structuring-a-friendly-acquisition>> accessed 20 September 2019.

<sup>147</sup> Alan Casey, 'A Snapshot of Irish M&A' (*Bowmans Law* January 2017) 32 <[http://www.bowmanslaw.com/wp-content/uploads/2017/01/Legal-Week\\_Global-MA-Guide-2017.pdf](http://www.bowmanslaw.com/wp-content/uploads/2017/01/Legal-Week_Global-MA-Guide-2017.pdf)> accessed 20 September 2019.

<sup>148</sup> Tino Gaberthuel, 'Particularities of the Swiss Takeover Law' (*Bowmans Law* January 2017) 40-41 <<http://www.bowmanslaw.com/wp-content/uploads/2017/01/Legal-Week-Global-MA-Guide-2017.pdf>> accessed 20 September 2019.

<sup>149</sup> Steven de Schrijver, 'M&A in Belgium – Current Trends and Outlook' (*Bowmans Law* January 2017) 10-13 <[http://www.bowmanslaw.com/wp-content/uploads/2017/01/Legal-Week\\_Global-MA-Guide-2017.pdf](http://www.bowmanslaw.com/wp-content/uploads/2017/01/Legal-Week_Global-MA-Guide-2017.pdf)> accessed 20 September 2019.

Mergers and acquisitions are the corporate attractions of choice of Asian Tiger nations such as South Korea and Singapore, as well as their near neighbour Japan. Embedded national political, social and economic preferences for restructuring mechanisms raises the question of whether corporations could be encouraged to consider schemes of arrangement when the other restructuring mechanisms have failed.

### **1.10. Research Topic Rationale**

The process of corporate restructuring is crucial for rejuvenating company operations and may be needed for extrinsic reasons, of ensuring obligation compliance, or intrinsic, the streamlining of its organisational structure. A structural overhaul is often a necessity when a business has reached the point at which its framework is no longer able to manage the production outputs, asset management or internal stakeholder needs, for example, of the company. It may, for example, demand the formation of subsidiaries for the diverse areas of the business to establish a more effective model of management and diversify production.

In this research, the KSA approach to corporate restructuring will be compared with that adopted in Western, Eastern and African countries of diverse cultures and political heritage. This will involve the essential evaluation of their respective approaches to corporate restructuring which differ markedly due to cultural based and secular differences, particularly the impact of *Shari'a*, which affects all aspects of personal, political and business life in the KSA. Most Saudi commercial enterprises, regardless of size, are family businesses, a fact which can have a major impact on issues such as transparency and disclosure. This makes the KSA a particularly interesting comparator to other national market frameworks as it is currently undergoing significant domestic developments and commercial transformation. The government has sought to engage in a number of national economic development plans and most recently it officially launched Vision 2030. This aims to transform the KSA into a thriving, non-oil dependent, business economy, a vibrant society and an ambitious nation that will provide a model of excellence in a wide range of areas by 2030.<sup>150</sup>

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<sup>150</sup> Saudi Arabia Vision 2030 <[vision2030.gov.sa/en](http://vision2030.gov.sa/en)> accessed 20 September 2019.

In the commercial context, the development plan seeks to encourage new inward investment opportunities and ensure that the KSA becomes more open to business. Its National Transformation Plan 2020 is intended to deliver significant expansion in investment, jobs and exports by incentivising economic development in the private sector.<sup>151</sup> In recent decades, the KSA has sought to encourage greater diversification in its economy away from dependence on its massive but finite national oil and gas reserves. As part of this transformation, the government has sought to modernise the economy, encouraging and facilitating the growth of other business areas. It is anticipated that this research will help to fill the gap in the academic literature on the new Bankruptcy Law and its contribution to the developing economic aims of the KSA.

#### *1.10.1. Research Questions*

The primary research question is as follows: ***With particular reference to the United Kingdom, the KSA and other selected jurisdictions, to what extent do schemes of arrangement provide an effective alternative to restructuring tools available under corporate law?***

In addition, the study seeks to address the following secondary questions:

1. What are the restructuring tools provided by company law and to what extent have they established themselves as effective solutions to reorganisation needs?
2. What is meant by the term 'schemes of arrangement' and how useful is this mechanism for restructuring organisations and resolving problems of potential or actual insolvency?
3. To what extent have schemes of arrangement experienced 'legal transplantation' in diverse jurisdictions? Have they simply replicated the UK model or have they undergone changes to attain alignment with the jurisdiction's market dynamics, trade practices, and politico-economic and socio-cultural environment?

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<sup>151</sup> Saudi Arabia National Transformation Programme 2020 <[vision2030.gov.sa/en/ntp](http://vision2030.gov.sa/en/ntp)> accessed 20 September 2019.



4. With specific reference to the KSA handling of restructuring mechanisms and its newly adopted schemes of arrangement, to what extent does *Shari'a* law stand in opposition to schemes of arrangement and the other restructuring mechanisms used in Western nations?
5. Would it be feasible and desirable to establish a global scheme of arrangement regime? What role, if any, might the KSA play in this process as an integral part of the globalised market economy?

### 1.10.2. Research Aims

The study aims to examine the extent to which new hybrid manifestations of national schemes of arrangement may be considered to offer a more flexible and efficient means of restructuring large corporate enterprises whilst balancing fairness and reasonableness in the interests of all parties involved in company reorganisation. It is further proposed to examine whether schemes of arrangement as implemented in the UK can prove effective outside the context of Europe, former British colonies and current members of the Commonwealth, and form a basis for the creation of a global regime. A particular focus will be on its viability in the KSA business structure, culture and market and its compatibility with *Shari'a*-compliant finance and investment practices which will affect the integration of the KSA into the international market.

### 1.10.3. Research Objectives

This research has five objectives, expressed as follows:

- i. To identify, critically examine and evaluate schemes of arrangement and determine whether or not they provide an effective alternative to the other restructuring mechanisms in different national and jurisdictional contexts. This ties in directly with the first research question.
- ii. To describe the Saudi economic imperatives and the operation of its corporations in the context of *Shari'a* to identify the national framework currently in practice for restructuring and supporting companies on the brink of insolvency and the compatibility of the newly introduced Saudi scheme of arrangement with its cultural foundations.

- iii. To determine the attractiveness of schemes of arrangement on the basis that they are more flexible, less time-consuming and more efficient than the other restructuring tools provided under national company law.
- iv. To evaluate schemes of arrangement for their comparative flexibility and effectiveness in providing solutions to already insolvent companies, and those in financial distress or at risk of liquidation.
- v. To undertake an analysis to determine the efficacy of establishing a uniform global restructuring mechanism to meet the needs of commerce.

### **1.11. Research Methodology**

The proposed research methodology will address the research questions using a combination of a doctrinal approach and comparative analysis. A doctrinal method is particularly suited for this research as it provides a basis for identifying and explaining the relevant laws relating to (i) the different ways in which companies can be restructured, and (ii) the different schemes of arrangement in practice. A comparative methodology that evaluates the similarities and differences in a range of jurisdictions can be used to analyse the functioning of the laws in practice in a selection of countries and evaluate their respective strengths and shortcomings. The aims and objectives of the research and the questions it addresses would be best satisfied through the employment of these methodologies rather than other approaches.

In order to provide a compelling set of explorations, examinations and academic opinions to facilitate the reaching of effective conclusions, the comparative study will focus on eight jurisdictions. Two are European, Ireland and Germany, while the other six represent countries that were either originally colonised by the British or are currently members of the Commonwealth. These are Australia, Canada, Germany, Hong Kong, Ireland, New Zealand, Singapore and South Africa. Each of these countries successfully employs a scheme of arrangement model which bears a strong resemblance to that of the UK but each is infused with its own national character. One cannot ignore the British historical factor when discursively analysing the schemes of arrangement in the mentioned countries.

This set of countries was selected for **two** main reasons. Firstly, schemes of arrangement have proven themselves viable and vital in all these jurisdictions in dealing with insolvent companies or companies headed towards insolvency. Secondly, in the case of those jurisdictions with particular ties to the UK, while their schemes of arrangement remain similar to that employed in UK law, they embed the cultural and political jurisdictional context in which they operate. It is contended that they will provide a basis for identifying common trends in the formal restructuring mechanisms employed to reorganise companies. Singapore indeed represents an interesting investment and business attraction trend, encouraging foreign and domestic corporate investment by becoming the venue of choice for corporate restructuring.<sup>152</sup> It has significantly developed its corporate laws specifically for the purpose of encouraging companies to come within its jurisdiction to facilitate that service.<sup>153</sup> Given that the UK example and experience has been integral to the adoption of the schemes of arrangement practice of these nations attention will be further focused on the impact of the UK withdrawal from the EU on the corporate restructure regimes of the UK and its former trade and political partners.

The KSA will also play a substantial role in this study and the selected methodology is perfectly suited for the analysis of the restructuring mechanisms in this country. Popularly viewed as a country wherein *Shari'a* law functions to deter investments and reject western restructuring mechanisms, the research will establish that this is a largely erroneous assumption. The inclusion of the KSA also provides a basis for assessing different mechanisms beyond the common law approach to identify how the reform of the insolvency law might be pursued in the Kingdom. On the basis of this rationale, it is argued that a doctrinal and comparative methodology is the most appropriate approach to fulfil the study's aims and objectives and address the research questions as framed.

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<sup>152</sup> Casey Watters, 'Singapore Amends Companies Act to Strengthen its Role as a Regional Restructuring Hub' (2017) 38(9) *The Company Lawyer* 293, 294.

<sup>153</sup> Ministry of Law Singapore, 'Recommendations Released on Strengthening Singapore as an International Centre for Debt Restructuring' (20 April 2016) <<https://www.mlaw.gov.sg/content/minlaw/en/news/press-releases/recommendations-released-on-strengthening-singapore-as-an-intern.html>> accessed 20 September 2019.

### 1.12. Future Prospects

It is generally accepted that globalisation is now a politico-economic and socio-cultural fact of life that impacts on social and economic affairs at every level, be it within the public or private sphere.<sup>154</sup> The internet and digital communications have also played a crucial role in the emergence and growth of globalisation and profoundly politically powerful multi-national corporations.<sup>155</sup> Companies, particularly those who have attained considerable advantage and growth, have welcomed this globalisation and e-commerce because they have facilitated transnational trade, financial investments. With respect to trade, economics and business, they have all but erased national boundaries or at least rendered them extremely fluid.<sup>156</sup>

On the other hand, some scholars argue that globalisation has been replaced by 'glocalisation', or the localisation of the global.<sup>157</sup> This phenomenon has impacted on media, politics, society and, more importantly for the purposes of this research, on the business, economic and financial sectors.<sup>158</sup> In practical terms, this means that multi-party business negotiations occur with participants in different locations or countries aided by teleconferencing, with business deals signed at the touch of a button, notarised within a period of hours and money transferred from one bank account to another in a matter of seconds.<sup>159</sup> Within this context, market competition can be characterised as being in constant flux, dynamic and ever-evolving. In this highly competitive business environment, large companies need to harness the ability to work together to strengthen individual business interests and develop flexible ways for enterprises to merge and restructure their operations.

There is a growing need to review the mechanisms available for restructuring companies, hence the attraction of the schemes of arrangement process, likely to become an increasingly

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<sup>154</sup> United Nations, 'Achieving Sustainable Development and Promoting Development Cooperation' (Department of Economic and Social Affairs 2008) 11 <[https://www.un.org/en/ecosoc/docs/pdfs/fina\\_08-45773.pdf](https://www.un.org/en/ecosoc/docs/pdfs/fina_08-45773.pdf)> accessed 20 September 2019.

<sup>155</sup> Luke Martell, *The Sociology of Globalisation* (Polity Press 2017) 49-50.

<sup>156</sup> *ibid* 49-50.

<sup>157</sup> Victor Roudometof, *Glocalisation: A Critical Introduction* (Routledge 2016) 69-71.

<sup>158</sup> *ibid* 69-71.

<sup>159</sup> *ibid* 70-72.

important mechanism for companies wishing to pursue change to their corporate framework and management of their obligations and output. However, much of the literature about restructuring companies tends to identify, explain and evaluate different restructuring mechanisms while the literature on schemes of arrangement focuses on simply tracing their development.

This research will make **three** principal contributions to knowledge. It will:

- i. critically assess whether schemes of arrangement provide a flexible and efficient means of restructuring companies,
- ii. evaluate how they provide a basis for addressing the weaknesses of the other restructuring mechanisms, and
- iii. analyse how such schemes adopted in global jurisdictions are applied to and serve the needs of national economies through the attraction of foreign corporations and encouragement of domestic entrepreneurship.

## **2. Chapter II: Schemes of Arrangement in the United Kingdom**

### **2.1. Introduction**

The company and insolvency legislation of the UK is a key factor in the examination of how a long history of law and practice can be implemented into the new, somewhat revolutionary, changes envisioned by the KSA in the restructure of its commercial and legal framework. The primary research question is predicated on the inherent adaptability and flexibility of the scheme of arrangement as an effective alternative to other restructuring tools available under corporate law. This study will question how the courts interpret and apply the law in a common law framework to effectively meet company restructuring needs and resolving insolvency issues. It will assist in answering the question of whether such a scheme can be effectively transplanted or simply replicated to attain alignment with the market dynamics, trade practices, and politico-economic and socio-cultural environment of the KSA jurisdiction.

The market is international and no country can rely on its regional or national commerce to thrive or simply survive. Transnational corporations are omnipresent. They are global producers of enormous wealth for domestic and host state economies and it is thus imperative that they are built around a solid organisational, political and legal infrastructure that will promote growth and fiscal security. They have profound importance in regional and national socio-economic growth and there are severe consequences in the event of failure.

The reorganisation options which avail of schemes of arrangement and debt restructuring are designed to place a distressed company in a stable position and allow it to grow, to rise from the potential fire of its assets, obligations and prospects. Schemes of arrangement are applied in the UK company law framework as a tool for rescuing companies which are insolvent or facing apparently irreversible decline. Such restructuring inevitably affects the pre-existing global contractual obligations of the company undergoing legal change. The principle of comity, the mutual recognition of laws and judicial acts across nations, provides a base for the

continued operation of the new company, even in countries which do not share a similar legislative procedure.<sup>1</sup>

In *Stripes US Holdings Inc*, Smith J considered that the English courts had jurisdiction to make the arrangements for the scheme of restructure that was approved by the company in the manner prescribed by legislation given that over a quarter by value of creditors were domiciled in the UK.<sup>2</sup> Nevertheless, the power to approve would have little effect without recognition and enforcement in the UK, the origin domicile of the company itself. The comments of the judge indicate he must be cautious in approving a scheme where it would “affront comity with courts” in the US or impinge upon the US Chapter 15 Bankruptcy Code.<sup>3</sup> He therefore received detailed evidence from a recognised American legal expert on the issue of recognition of his order before approval. However, he noted that, ultimately, any action on the scheme by US creditors lay within the jurisdiction of their local court.

The discussion in this chapter covers four core themes:

- i. tracing the origins and development of schemes of arrangement in the UK, examining how they have evolved over two centuries of national, economic change;
- ii. an examination of the current statutory framework, exploring the role of the courts in reviewing, questioning and approving their specific application to diverse circumstances of business needs;
- iii. whether and how schemes of arrangement in the UK represent a means by which to restructure companies by evaluating their strengths and weaknesses as mechanisms of reform and fulfilment of purpose and plans;
- iv. explain how the schemes of arrangement are not only for the distressed user, but play an essential part in accommodating financial, growth and structural demands as corporations develop.

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<sup>1</sup> Mark G Douglas, ‘Cross-Border Bankruptcy Battleground: The Importance of Comity (Part I)’ (Jones Day March/April 2010) <<https://www.jonesday.com/Cross-Border-Bankruptcy-Battleground-The-Importance-of-Comity-Part-I-03-31-2010/>> accessed 20 September 2019.

<sup>2</sup> *Stripes US Holdings Inc* [2018] EWHC 3098 (Ch)

<sup>3</sup> *ibid* para 65-66.

It would be remiss to fail to explore potential impact of Brexit on companies which will have to adapt to new global trading rules and structures and rearrange their organisation by schemes of arrangement to accommodate operation in an increasingly uncertain market.

Schemes of arrangement originated as a mechanism for restructuring companies, with a particular focus on those facing financial difficulties. They were intended to provide a lifeline for such companies, a tool for debt and organisational restructuring and the time to address their pecuniary problems before or after commencement of formal insolvency proceedings. This chapter therefore seeks to explain how schemes of arrangement provide an effective alternative to other restructuring tools available under corporate law in the UK. It also intends to be a basis for discussing their value in the other jurisdictions reviewed.<sup>4</sup>

It will be argued that schemes of arrangement are more flexible and efficient and time-saving than other restructuring mechanisms such as mergers and acquisitions, with court oversight in the practical balance of fairness to the interests of all stakeholders. In order to demonstrate this, exploratory and explanatory modes of enquiry are adopted. The exploratory method will address the nature of schemes of arrangement and how they function under UK law while the explanatory process is employed will consider the rationale for the current statutory framework and its value to corporate restructuring. Three significant issues arise, namely (i) the creative role played by judges in interpreting the legal provisions regulating schemes of arrangement in the UK, (ii) the reasons for the revival of the schemes and (iii) the extent of ‘restructuring tourism’, that is, foreign companies availing themselves of the services of the UK legal system to change the nature of their operations and liabilities, particularly those of a financial nature.<sup>5</sup>

Paterson asserts that “schemes have been used to implement not only debt restructurings ... but also to amend existing debt arrangements to loosen covenants, extend maturities or even

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<sup>4</sup> Chapters III and IV focus on Saudi Arabia and other selected jurisdictions.

<sup>5</sup> Elena Moya, ‘London Risks becoming “Brothel” for Bankruptcy Tourists’ (The Guardian 31 January 2010) <<https://www.theguardian.com/business/2010/jan/31/insolvency-uk-law-bankruptcy-foreign>> accessed 20 September 2019.



to implement a moratorium whilst a restructuring is agreed".<sup>6</sup> The objective is comparable to, and adopted by, other countries, especially those within the Commonwealth. Simply stated, schemes of arrangement offer companies the requisite time to restructure their organisation, to make any necessary internal changes, and to devise more realistic strategic organisational objectives and the means by which to attain them. The objective of this mechanism is for a company to re-emerge as a vital and viable entity in the short, medium and long term.

## 2.2. *Origins and Development of Schemes of Arrangement*

As noted in Chapter I, there are at least **three** major methods in which a scheme of arrangement can be utilised<sup>7</sup>. The first step is a voluntary plan adopted by the directors of a company, its creditors and shareholders in order to actualise a reorganisation of the company.<sup>8</sup> The voluntary nature of the arrangement indicates that the parties to the scheme are inclined to seek a new mode of operation to achieve a common goal or equal benefits.<sup>9</sup> Section 896 of the UK Companies Act 2006 (CA 2006) regulates the implementation of such scheme in practice to ensure fairness and minimisation of prejudice, particularly to minority shareholders in the event of a dispute.

The second is the pursuit and approval, or oversight, of the corporate rearrangement scheme arises after an application to the court following its affirmation approval by the requisite majority of the company's shareholders, normally 75%, and creditors.<sup>10</sup>

Finally, the process of reorganisation under the scheme is court approval of the arrangement and the issue of the order that approves and sanctions the restructure making it binding upon

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<sup>6</sup> Sarah Paterson, 'Reflections on English Law Schemes of Arrangement in Distress and Proposals for Reform' (LSE Law Department 2017) 2 <[https://www.law.ox.ac.uk/sites/files/oxlaw/paterson\\_schemes\\_of\\_arrangement.pdf](https://www.law.ox.ac.uk/sites/files/oxlaw/paterson_schemes_of_arrangement.pdf)> accessed 20 September 2019.

<sup>7</sup> See Chapter I, 1.7.

<sup>8</sup> Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge University Press 2014) 18-19.

<sup>9</sup> Jan-Jaap Kuipers, 'Schemes of Arrangement and Voluntary Collective Redress: A Gap in the Brussels I Regulation' (2012) 8(2) *Journal of Private International Law* 225, 229-231.

<sup>10</sup> Christian Pilkington, *Schemes of Arrangement in Corporate Restructuring* (Sweet and Maxwell 2013) 15-19.

the parties.<sup>11</sup> It is noted that section 896 of the CA 2006 enables the court to call a meeting of a class of creditors or shareholder-members, who consider themselves at a disadvantage to the majority interests in a restructure scheme and to adjudicate on the comparative influence of their views. Zhen Qu summarises in the context of Hong Kong that schemes are necessarily predicated on a binding agreement amongst a majority of stakeholders which modifies the legal rights of shareholders and creditors.<sup>12</sup> The court in *SABMiller Plc*<sup>13</sup> indicated that it will not generally interfere with the will of the majority in effecting an agreed scheme of arrangement, given the purpose of the legislative provision was the promotion of such plans which reflect the wider interests of the company.

In order to fully understand the development, adaptation, construction and application of schemes of arrangement in the UK, it is necessary to provide an overview of their historical development toward the current statutory framework. This provides a foundation for consideration of their need and value, and evolution from their simple use as a device to deal with corporate financial distress toward a source of streamlining and strength for a future in a challenging global market.

Although the focus of this study is on schemes of arrangement, it is noted that alternative statutory procedures are available to companies for debt restructure under the Insolvency Act 1986 (IA 1986). The CVA under Part 1 of the IA is a somewhat less fundamental reorganisation process, overseen by the court but through the supervision of a corporate nominee who is generally an insolvency practitioner. It has no impact upon secured creditors and thus limited in its scope for restructure. Only the unsecured will lose in this arrangement and this limits the prospects of rescue from demise where charge-holders, recognising risk, seek to realise their debt.<sup>14</sup>

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<sup>11</sup> Geoff O'Dea, Julian Long and Alexandra Smyth, *Schemes of Arrangement: Law and Practice* (Oxford University Press 2012).

<sup>12</sup> C Zhen Qu, 'Towards an Effective Scheme-Based Corporate Rescue System for Hong Kong' (2012) 12 *Journal of Corporate Law Studies* 2012, 85.

<sup>13</sup> *SABMiller Plc* [2016] EWHC 2153 (Ch) All ER (D) 47.

<sup>14</sup> Jennifer Payne, 'The Role of the Court in Debt Restructuring' (2018) 77(1) *Cambridge Law Journal* 124.

Administration under Schedule B1 of the IA 1986 is only advisable where risks of financial demise have become critical and the company is heading toward liquidation. In such circumstances, under Part 3 Insolvency Rules 2016, an administrator, insolvency practitioner, is appointed by the company or court “to manage the company’s affairs, business and property.” Authority in dealing with corporate assets is removed from the directors, who arguably should have implemented a scheme of arrangements at an earlier stage to seek fundamental reorganisation of its financial affairs. Much of the emphasis of administration is to pre-pack and sell the underlying business.<sup>15</sup> This study is aimed at the rescue of the company, not simply the business. Neither of the main IA procedures allow for cram down of minority interests which inhibit rescue.

### 2.2.1. History of Schemes of Arrangement

Schemes of arrangement were legislated for by the UK Parliament in the 1860s to address the basis for the conduct of company affairs and arrangements, giving “great legal freedom to organise the internal governance structures of a company”.<sup>16</sup> The passage of time and law saw schemes of arrangement evolving alongside developments in the British and international markets as corporations adapted, or failed to do so, to increasing competition and turbulence in global trade and politics. As a method of restructuring to meet financial challenges, the concept of the schemes demonstrated a flexibility which allowed the law to remain aligned to market and commercial needs of the economy it served.<sup>17</sup>

The first formal legislative based schemes of arrangement model can be traced back to section 136 of the Companies Act 1862, which allowed companies that were being voluntarily wound up to enter into an agreement with their creditors or members for the distribution of remaining asset shares. The consent of 75% of shareholders and 75% of holders of the company’s debt was required to give effect to the proposed liquidation agreement. Consenting parties were not required to seek court approval for the arrangement, but those in dispute were enabled to

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<sup>15</sup> Bob Wessels and Stefan Madaus, *Rescue of Business in Europe* (Oxford University Press 2017) 613.

<sup>16</sup> Richard Nolan, ‘The Continuing Evolution of Shareholder Governance’ (2006) 65 *Cambridge Law Journal* 92, 102.

<sup>17</sup> *ibid*

appeal the majority decision. The requirement to cease trading could of course be imposed on the company, either by financial distress or active shareholder action, under section 159 of the 1862 Act. In the case of a compulsory winding-up application by a shareholder or creditor body, the court would appoint a liquidator to negotiate with creditors, although, again, dissenters had the right of appeal against compulsory imposition of an arrangement.<sup>18</sup> This study may make reference to such powers, but the modern schemes of arrangement are examined in the context of seeking continuance of corporate operations by reorganisation.

A fundamental weakness of the first formal schemes of arrangement was the fact that they did not deal with the issue of binding dissenting creditors. Section 2 Joint Stock Companies Arrangement Act 1870 required a minimum of 75% of the creditor value holders and a simple majority of creditors to attend a general or special meeting to agree upon the proposed arrangement. Minority creditors were potentially prejudiced in the protection of their interests by the demands of larger, more financially exposed creditors, who could effectively progress an arrangement which satisfied their specific needs in the hope of compelling the agreement of the weaker interests. However, it also potentially facilitated lesser creditors to resist reorganisation proposals as their own negotiating tool, by withholding support and enhancing their claim at restructure.<sup>19</sup> Such tactical measures are no longer afforded by the court in the modern legislative scheme.

A further weakness in the legislation was that companies could only use this mechanism when they were in the process of being wound up, on a voluntary or compulsory basis. They were generally at risk in their ability to survive an impending financial crisis, but were unable to preempt and avoid liquidation through the utility of a scheme until effectively reaching the point of failure. This criticism was highlighted in the 1906 Loreburn Committee review of the limitations upon schemes of arrangement which considerably restricted their potential and legitimate

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<sup>18</sup> Harry Rajak, *Company Rescue and Liquidation* (Sweet and Maxwell 2017) 329-330.

<sup>19</sup> Michael Pabst and Luke D Johnson 'Hold-outs Beware: UK Schemes of Arrangement and Chapter 11 Lie in Wait' (Jones Day 12 August 2013).

value to the company entity, its members and stakeholders, especially insofar as the very limited protection offered to floating charge holders is concerned.<sup>20</sup>

The company, represented by its directors, postulates a need for debt restructuring and a scheme of arrangement, perceived as being the means by which it will regain solvency and, eventually, climb out of debt and expand the value of the company. The argument is strong and the plan for recovery sound, supporting the logical and reasonable use of available reorganising instruments available to the company through which solvency, survival and market competitiveness can be attained. On the foundation of these particular parameters, one would assume that the company directors, or those acting on behalf of the company, are making a solid argument for facilitating rescue and perhaps subsequent growth which would find approval amongst company members. It is, nevertheless, entirely a decision for the directors, bearing in mind their duty to promote the success of the company. Section 172 of the CA 2006 simply requires that the duty be exercised in good faith, taking account of the various interests in corporate financial matters including distress. There is no penalty for not making what appears to be a prudent business decision in the absence of evidence of *mala fides*. The court will not intervene because 'it is for the directors to judge' what is in the interests of the company.<sup>21</sup> The 'Business Judgement Rule' creates a strong judicial presumption that directors will fulfil their statutory duties and act in the best interests of the company, and the court should not substitute its own view.<sup>22</sup> Although not specifically legislated for in the UK, it has received broad support from the courts.<sup>23</sup>

A minority dissent to the 1906 Board of Trade Report pointed out that bankruptcy does not create the same fear and stigma for veiled directors as it does for individual traders, even in the case of reckless trading practices that cause financial distress. There is no personal discredit. Nevertheless, with the unrestricted authority of directors to incur loan liabilities and charges

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<sup>20</sup> Board of Trade, *Report of the Company Law Amendment Committee* (Cd 3052, 1906) para 15.

<sup>21</sup> *Hutton v West Cork Rly Co* (1883) 23 Ch D 654, 672 (Bowen LJ).

<sup>22</sup> Andrew Keay and Joan Loughrey, 'The Concept of Business Judgment' (2019) 39 (1) *Legal Studies* 36 <<https://www.cambridge.org/core/journals/legal-studies/article/concept-of-business-judgment/DFC0700879FEF7FF4BD7E9A589A211C4>> accessed 20 September 2019

<sup>23</sup> See *Birdi v Specsavers Optical Group Ltd and others* [2015] EWHC 2870 (Ch).

over company property, the standards of conduct and duties imposed should be similar to those where personal liability is imposed in order to regulate borrowing to levels which the company can prove its ability to meet. This would decrease the risks of 'excess borrowing'.<sup>24</sup>

Stakeholders, members and shareholders may not be supportive of the arrangements made by directors to facilitate the continued operation of the company as it potentially trades its way out of distress. However, while section 172 of the CA 2006 requires their interests to be taken into account, the duty is owed to the company. A dissenting minority is clearly, and rightly, concerned about the future of their investment because they currently face loss and hold less control over their own fates than members and majority supporters. Their argument carried considerable logic. The loans to corporate persons, the directors, should be treated as those made to recipients according to the value of the assets which the bank or creditors could convert to cash. In the scheme of arrangements process, however, the company's interests will prevail over those of all others, which is suggestive of the tokenism of the director's duty under section 172.<sup>25</sup>

Even if they are financially insolvent, the company's fixed and current assets, compounded with its potentially continuing functions, operations and processes, generate money unlike real people. These latter individuals may have salaries and investments but they are not taken into account unless they are liquidated or form part of a loan securitisation. Companies have the corporate advantage of entering markets and competing with their products and services, which provide, if well-managed, a continuous source for the generation of new money. Lines of credit may therefore be extended to companies, even those facing insolvency, with an attractive rescue scheme of arrangement. However, these also involve additional security and charging requirements from lenders, personal guarantees from directors for the new 'investment', which, in turn, could give rise to issues of preference in the event of insolvency.<sup>26</sup>

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<sup>24</sup> Board of Trade (n 20) para 28.

<sup>25</sup> Rachel C Tate, 'Section 172 CA 2006: The Ticket to Stakeholder Value or Simply Tokenism?' (University of Aberdeen 2007) 7 <<https://www.abdn.ac.uk/law/documents/Section172CA2006-thetickettostakeholdervalueorsimplytokenism.pdf>> accessed 20 September 2019.

<sup>26</sup> Section 239, Insolvency Act 1986. Also note sections 238, 245 and 423

In *MC Bacon Ltd*,<sup>27</sup> for example, the liquidator unsuccessfully attempted to overturn a floating charge in the realisation of assets he argued were charged at an undervalue, the court finding a simple grant of security was not an undervalue transaction.<sup>28</sup> The costs of the litigation, borne by the estate, were thus arguably unnecessary. The treatment of floating charges in administration has now been superseded by the Enterprise Act 2002 (EA 2002) which does not form a focus in this study.

Debt restructuring and internal reconstitution rejuvenates corporate prospects and management, potentially strengthening its financial circumstances and placing it on a path to liability satisfaction and profitability. This does not imply, however, that the dissenting opinion of the minority to an otherwise appealing scheme is misplaced; a company can once again fall prey to the forces which led it to financial insolvency. This has the potential for entry into Schedule B1 of the IA 1986, Administration. It is a curious effect of such a development that minority interests and debts which were crammed down in the failed Scheme process cannot now be resurrected in Administration, where they would have been at least partially honoured had the scheme not occurred. This remains a factor for practitioner reflection in Part 26 of the CA 2006.

Nevertheless, if efficacious and fair, companies should be given the opportunity of planning and performing its way back to success. It is further noted from this example to the 1906 Committee that option of the voluntary winding-up of a company is not necessarily synonymous with financial difficulties. It is evident from the historical perspective that legislative reform was necessary to the original schemes of arrangement to resolve inherent problems and adapt to corporate and market developments. Determination can now be made on how the current statutory framework in the UK has evolved the practice of scheme of arrangement implementation to provide a basis for restructuring companies other than those

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<sup>27</sup> [1991] Ch 127.

<sup>28</sup> David Pomeroy and others 'Undervalue claims: the art of stating the obvious?' (Guildhall Chambers) <[https://www.guildhallchambers.co.uk/files/6Undervalue\\_Claims\\_HS&DP.pdf](https://www.guildhallchambers.co.uk/files/6Undervalue_Claims_HS&DP.pdf)> accessed 20 September 2019.

facing financial difficulties. The following analysis seeks to identify the present salient features and peculiarities.

### 2.2.2. Current Statutory Framework

The CA 2006 was designed “to reform company law and restate the greater part of the enactments relating to companies; to make other provision relating to companies and other forms of business organisation”.<sup>29</sup> It is broadly a consolidating, regulatory Act, Companies are left to look after their own affairs, subject to the Financial Reporting Council requirements of “openness, integrity and accountability”.<sup>30</sup> The scheme of arrangement, for example, will involve negotiation and agreement between a company, its creditors and its members with a view to its own resolution of reconstruction needs. The limited role of the court in the oversight of the process ensures creditors are fully informed of the nature, basis, motivation and market circumstances of scheme restructure, and, in the sanctioning procedure, the legislative obligations on the company have been fulfilled.<sup>31</sup> The aim of the High Court in determining approval of the scheme and its procedural compliance is concisely stated by Falk J. in *Synchreon Group BV*<sup>32</sup>; the scheme what “an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve”.<sup>33</sup> As a basis for monitoring of Part 26 of the CA 2006 process this embeds the principles of fairness which pervade the legislation in the protection of diverse classes of interests which is founded principally on the rescue of a viable company which inevitably involves a level of sacrifice and loss for the greater good.

A special meeting to examine and discuss the plans and proposals may be called by the company pursuant to section 896(1) of the CA 2006. However, a creditor may also apply to the court for a special meeting. This is a rarely utilised entitlement, which generally only arises in a

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<sup>29</sup> Companies Act 2006, Introduction.

<sup>30</sup> Andrew Ross and Peter Williams, *Financial Management in Construction Contracting* (John Wiley & Sons 2012) 48.

<sup>31</sup> Payne (n 14)

<sup>32</sup> [2019] EWHC 2412 (Ch).

<sup>33</sup> *ibid* para 23.



hostile takeover attempt that is not accommodated by any CA 2006 provisions.<sup>34</sup> Such an application runs contrary to the statutory purpose of a scheme of arrangement which is enacted to achieve a consensual arrangement to deal with debt.<sup>35</sup> The court can approve an initial meeting.<sup>33</sup> However, without the company's consent, it would not be able to sanction any resulting agreement.<sup>36</sup>

Provided the plan is formulated according to the regulations, it will then simply be put before the court for consideration and approval. In *Uniq Plc*, for example, David Richards J confirmed that an agreement allowing debt to be swapped for company shares was a lawful means of securing its future as long as all legal requirements pertaining to the agreement were fulfilled.<sup>37</sup> This was despite the fact that such a benefit and value scheme of arrangement is of questionable value in corporate restructuring given its complexity and cumbersome nature.<sup>38</sup>

In *Uniq Plc*, the court decided it was not for them to question the choices made by the affected parties. Companies should look after their own commercial interests without asking the court to change what has been negotiated; "parties are free to contract as they please and that the courts will enforce their agreements – *pacta sunt servanda*".<sup>39</sup> The court will, however, seek to protect minority members and creditors in particular from threats of restructure. Payne identifies these threats as (i) its potential use for wealth transfers between stronger creditors, (ii) its use as a moratorium by managers wishing to prop up non-viable companies and shake-off liabilities that it is capable of servicing, and (iii) its use as a means of seeking rescue finance from new creditors who supersede the rights of the existing.<sup>40</sup>

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<sup>34</sup> Companies Act 2006, Section 896(2)(b).

<sup>35</sup> *Savoy Hotel Ltd* [1981] Ch 351.

<sup>36</sup> *ibid.*

<sup>37</sup> *Uniq Plc* [2012] 1 BCLC 783 at para 3.

<sup>38</sup> Department of Trade and Industry and the Treasury, *Report of the Joint DTI/Treasury Review of Company Rescue and Business Reconstruction Mechanisms* (HMSO 2000). See also: Insolvency Law Review Committee, *Insolvency Law and Practice* (HMSO 1982).

<sup>39</sup> *Cavendish Square Holding BV (Appellant) v Talal El Makdessi (Respondent)* [2015] UKSC 67 para 257

<sup>40</sup> Payne (n 14).

Additional finance is a necessity in rescue situations and new creditors will seek safeguards for the risks undertaken in supporting a distressed company.<sup>41</sup> There is little guidance from, for example, the Insolvency Service as to the achievement of this balance and whilst Payne suggests that liens of diverse priority and floating charges over assets are likely to be used in existing creditor protections, the exact form that these will take is critical.<sup>42</sup> Other options such as invoice discounting and debt factoring are used to raise capital while jettisoning the administrative inconvenience of collection.<sup>43</sup>

Nevertheless, restructuring debts is essentially a private, contractual matter, and in the case of financial distress, the court must safeguard the interests of the company against those who seek to block rescue arrangements for their own motives and purposes.<sup>44</sup> Time limits, procedural compliance and non-interventionist judicial oversight are the primary features utilised by the statutory framework of the scheme under Part 26 of the CA 2006 to ameliorate internal risks to survival. It can be noted that the courts have proved a valuable resource in determining compliance with the law and its procedures before entering into the necessary expense of the scheme of arrangement and facilitating alternative paths of rescue.<sup>45</sup>

### 2.2.3. Flexibility of Utility

According to the statutory procedure under Part 26 CA 2006, a scheme of arrangement allows a company to reach an agreement with its shareholders, creditors or both by seeking majority assent to a scheme which involves mergers or acquisitions. It is noted that the scheme of arrangement procedure forms part of company law rather than insolvency, reflecting its broader value to business organisations compared to simple situations of financial distress or,

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<sup>41</sup> *ibid.*

<sup>42</sup> *ibid.*

<sup>43</sup> Leora Klapper, 'The Role of Factoring for Financing Small and Medium Enterprises', (World Bank Policy Research Working Paper 3593 May 2005) 3  
<[https://www.insol.org/emails/Mar\\_2015\\_downloads/Independent%20Advisory\\_Does%20the%20S%2015%20Compromise%20Further%20the%20%20Objectives%20of%20Business%20Rescue.pdf](https://www.insol.org/emails/Mar_2015_downloads/Independent%20Advisory_Does%20the%20S%2015%20Compromise%20Further%20the%20%20Objectives%20of%20Business%20Rescue.pdf)> accessed 20 September 2019.

<sup>44</sup> *ibid.*

<sup>45</sup> See, for example, *Royal London Mutual Insurance Society Ltd* [2018] EWHC 2215 (Ch) and *Bibby Offshore Services Plc* [2017] EWHC 3402 (Ch).

for example, member voluntary liquidations as the company decides to stop trading or has fulfilled its purpose. This explains the importance of market assessments and projections which form part of the disclosure process.<sup>46</sup>

It is to be noted that these evaluations, expensively come by through the expertise of accounting and legal practitioners, matched with the comprehensive review of the company finances and future, will not only aid a rescue strategy preparation, but in the event of failure, aid administration.<sup>47</sup> This will be the case where the scheme fails to be approved or in its operation. Much of the work to be undertaken by an administrator or liquidator will already have been done, assets identified, and the sale of the business and distribution of assets is facilitated and eased. As a broadly stand-alone method of asset distribution as the company comes to an end, Shikha suggests “practice has shown that distribution of the company’s assets can be effected more quickly and expeditiously through a scheme than a winding-up, in which case the scheme will operate alongside the winding-up.”<sup>48</sup> This would only be suitable, however, for large companies with the financial resources to meet the expense inherent in the scheme.

The schemes have been used for takeovers and mergers, not necessarily in contexts of corporate financial distress and have proved an attractive method to effect internal organisational and stakeholder liability reform. In 2009 alone, in the midst of dealing with the global effects of the economic crisis and increasing business bankruptcy levels, three companies underwent mergers by way of a scheme: Emerald Energy Plc was taken over by Sinochem Corporation, Spring Group Plc by Adecco SA and BPP Holdings Plc by Apollo Global Inc.<sup>49</sup> None of these were hostile takeovers but negotiated and planned under formal proposed schemes with the requisite majority vote amongst company members, shareholders and creditors.

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<sup>46</sup> See, for example, *Bibby Offshore Services Plc* [2017] EWHC 3402 (Ch). Also, see FESCO, ‘Bondholder Presentation’ <[https://www.fesco.ru/upload/iblock/01e/fenix\\_bondholder\\_presentation\\_public\\_20160712\\_short.pdf](https://www.fesco.ru/upload/iblock/01e/fenix_bondholder_presentation_public_20160712_short.pdf)> accessed 20 September 2019.

<sup>47</sup> Neeti Shikha, ‘Takeover through Scheme of Arrangement: A Changing Trend in UK’ (2013) 38(1) *Vikalpa* 87.

<sup>48</sup> *ibid*, 89.

<sup>49</sup> Patrick A Gaughan, *Mergers, Acquisitions, and Corporate Restructuring* (Wiley and Sons 2018) 183-184.

Such a scheme was used in the purchase by Medco Energi Global of *Ophir Energy Plc*, both multinational conglomerates with complementary oil, gas and production interests in diverse parts of the world.<sup>50</sup> It was a takeover by simple transfer scheme and involved the scheme shares being transferred to Medco, the new parent company, in exchange for cash. The plan attracted the attention of competitors, and a bidding war sought to undermine the scheme proposal. Snowden J indicated that (i) probity in the procedural practice of the legislation was the guiding factor in the court sanction; (ii) there was no coercion of shareholders who were fairly represented; (iii) the scheme was capable of approval by “an intelligent and honest person, a member of the class concerned and acting in respect of his own interest”<sup>51</sup>; and (iv) “there must be no blot on the scheme”.<sup>52</sup> The original scheme was sanctioned, albeit on the basis of an improved purchase offer from Medco.

They are now commonly used as a mechanism to merge companies or provide a more stable future for those in financial difficulties and for a restructure of operations.<sup>53</sup> Their popularity as a flexible resolution process in the UK may be attributed, at least in part, to the pragmatic approach that courts have adopted to reviewing and sanctioning the schemes without excessive interference in the affairs or wished of the corporations.<sup>54</sup> This facilitates a less disruptive merging of complementary interests between companies, which is particularly important when the survival of one of the businesses is at stake. A case in point is the scheme of arrangement effecting the merger of Flybe Airlines and Connect, comprising Stobart Air and Virgin, amongst others, in 2019.<sup>55</sup> The companies were not direct competitors on their diverse routes of operation, but each had their own commercial interests in survival and expansion. Flybe provided a cheap short-haul flight service whilst also serving as a feeder for long-haul

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<sup>50</sup> *Ophir Energy Plc* [2019] EWHC 1278 (Ch).

<sup>51</sup> *ibid* para 18.

<sup>52</sup> *ibid*.

<sup>53</sup> Nicholas Norris, ‘Schemes of Arrangement’ (2001) *International Financial Law Review* 25, 25-26.

<sup>54</sup> For example, *Marconi Corp Plc* [2013] EWHC 324.

<sup>55</sup> *Flybe* [2019] EWHC 631 (Ch).

carriers with a strong and reliable business management strategy.<sup>56</sup> However, currency fluctuations and high fuel costs undermined the continuing financial efficacy of the company.

It was further noted by its CEO that Brexit confusion, discussed in the course of this chapter, also played a major part in the restriction of investment options available to the company. It is indicative of the foresight and planning of the directors that they were able to foster relationships with associated carriers, namely Connect and Virgin, to secure the future of the company and the continued employment of its staff in a stronger interrelated corporate service structure.<sup>57</sup> The arrangement further consolidated the control of the new owner companies in the merger process over their own business and operational contexts, achieved with a proposed, considerable investment injection into the company.

The effective takeover of a financially distressed Flybe, approved by 82% of shareholders and subsequently by the court, resulted in the agreed cancellation of Flybe shares and the de-listing of the company and its subsidiaries.<sup>58</sup> The Flybe Group now exists in name only and is a non-trading entity with no subsidiaries or assets, save for cash to discharge the transactional costs of the procedure. The shareholders effectively lost their investment. Bosco has pointed out that in the takeover of distressed companies which have limited attraction shareholders have little to gain from the process and are generally left out of the decision-making process.<sup>59</sup> Their expectations have to be realigned and reset.<sup>60</sup> This appears to have been achieved by Flybe given the level of support for and understanding of the commercial needs of the company. The environment for the investment by Connect and Virgin was clearly identified and cooperation

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<sup>56</sup> Christine Ourmières-Widener, 'Company Announcements – Stobart Group Ltd, Flybe Group PLC – Recommended Cash Offer for Flybe Group' (Financial Times 11 January 2019) <<https://markets.ft.com/data/announce/detail?dockey=1323-13931233-61FO8LMAONOAGIM79T3MERA7MK>> accessed 20 September 2019.

<sup>57</sup> *ibid.*

<sup>58</sup> Flybe Group, 'RNS Release: Shareholders Approve Connect Airways Acquisition' (Proactive 4 March 2019) <[https://www.proactiveinvestors.co.uk/LON:FLYB/Flybe-Group/rns/LSE20190304153911\\_13989530](https://www.proactiveinvestors.co.uk/LON:FLYB/Flybe-Group/rns/LSE20190304153911_13989530)> accessed 20 September 2019.

<sup>59</sup> Carlo Bosco, 'Creating Value in Distressed M and A Transaction' in Graham Lane, *Restructuring and Workouts: Strategies for Maximising Value* (3<sup>rd</sup> edn, Globe Law and Business 2019) 102-106.

<sup>60</sup> *ibid.* 106.

took place for the mutual benefit of all the parties involved. This, considers Bosco, is somewhat unusual where financial difficulties are an issue in the buyer universe.<sup>61</sup>

A further example is the fashion retailer New Look which incurred an unsustainable level of debt; it was going to result in its liquidation if not resolved by reorganisation and restructure.<sup>62</sup> The company sought to determine the views of the court regarding jurisdiction, creditor protection and potential scheme effectiveness. It was, on the face of it, a preliminary investigation into the issues regarding the requirements the court will demand to approve a scheme. This facilitated the operation of the scheme, aided by creditor support, and eased the company takeover. Given that in the opinion of the court the schemes proposed would effect the saving of the business if not the company *per se*, the pre-application facilitation provided by an experienced judiciary in this case is invaluable to corporate management and potential new owners in establishing the likelihood of acceptance of a proposal, subject to creditor approval, by the court.

The flexibility of the scheme of arrangement may indeed facilitate the search for partners in the corporate market, enabling the court to consider the implications of a scheme before the formal procedure begins. In *Old Mutual Plc* at the Court of Appeal, the company took what was essentially a pre-scheme step of placing its proposals for restructure by de-merger of parts of the business to the court for permission to proceed to a creditors and members meeting.<sup>63</sup> The managed separation of parts of the company under two schemes involved share cancellation of interests in the original company, and the reissue in the new was put before the court as a preliminary matter to the calling of a meeting. Old Mutual considered it prudent to seek a judicial opinion, if not approval, prior to embarking on the formal legislative process. Snowden J agreed with its course of action, stating: "I consider that to be an entirely sensible and appropriate course for the Company to take so as to avoid any wasted time and expense were

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<sup>61</sup> *ibid.*

<sup>62</sup> Kathy Stones, 'Class and Jurisdictional Issues in Schemes of Arrangement (Re New Look Secured Issuer Plc and Another)' (LexisNexis 29 May 2019) <[https://www.lexisnexis.co.uk/blog/restructuring-and-insolvency/class-and-jurisdictional-issues-in-schemes-of-arrangement-\(re-new-look-secured-issuer-plc-and-another\)](https://www.lexisnexis.co.uk/blog/restructuring-and-insolvency/class-and-jurisdictional-issues-in-schemes-of-arrangement-(re-new-look-secured-issuer-plc-and-another))> accessed 20 September 2019.

<sup>63</sup> *Old Mutual Plc* [2018] EWHC 873 (Ch).

it to turn out to be the case that the court later took a different view to that of the Company on these key points".<sup>64</sup>

#### 2.2.4. Procedures in Takeovers, Mergers and De-mergers

Goldrein outlines three steps established by statute and the courts to give effect to a scheme of arrangement, which begins with discussions and negotiations between officers, members and creditors on a restructuring plan which, on agreement, is placed before the creditor classes on a formal meeting called by the court under section 896 of the CA 2006.<sup>65</sup> Where, in the course of the court ordered meeting, there is agreement on to a 75% majority of shareholder ownership, step three is implemented, namely the obtaining of consent of the court, and recording of the restructure by the Registrar of Companies. Chadwick LJ, in *Hawk Insurance Co Ltd*, noted that the court has a duty to ensure all parties affected by the scheme have been identified and notified by the company of their right to be present at the special meeting and of the proposals for restructure, with 75% majority approval required.<sup>66</sup> The role of the court is supervisory in that it must ensure meetings are conducted in accordance with its orders, the requisite majority approval is met and dissenters' views are impartially considered.<sup>67</sup>

The approval of the scheme by the court binds all creditors and members in the amalgamation of companies. Shikha notes that in the traditional takeover banks may be reticent in lending to the parties where the holding they acquire is limited by the approval level of existing creditors and members.<sup>68</sup> The scheme procedure, overseen by the courts, and albeit cumbersome and expensive, offers greater certainty to new lenders where prior existing interests are either crammed down or bound by the new arrangements. This is particularly vital to new lenders

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<sup>64</sup> *ibid* para 7.

<sup>65</sup> Alastair Goldrein, 'Ready, Willing and Able, but Perhaps Not Always Acceptable: UK Schemes of Arrangement in Europe' (2011) 7(2) *Partt's Journal of Bankruptcy Law*. 113, 114-116.

<sup>66</sup> *Hawk Insurance Co Ltd* [2001] EWCA Civ 241.

<sup>67</sup> *ibid* para 12.

<sup>68</sup> Shikha (n 47), 90.

where 'colossal' amounts of money are involved, and indeed the company shareholders make considerable savings on stamp duty.<sup>69</sup>

The formulation of schemes of arrangement and role of the court in their approval is not an adversarial process, the aim being to reach compromise between the parties for the betterment of the company's continued operation. Negotiation, drafting, approval and implementing the scheme is subject to focused oversight at the two key stages of the planning as noted, but not in the sense of controlling the procedure or passing opinion on the efficacy of the strategy. It is noted, however, that, in the case of relatively non-contentious change of control over the company, this could be better undertaken by less costly internal procedures rather than involving the courts.<sup>70</sup>

In *Old Mutual* the High Court provided a valuable platform to assess the legality of proposals to be put to a meeting of creditors and members and to ensure compliance with the legislative provisions. It is not only the role of the court to determine that the technicalities of legal procedure are followed, but also to ensure that those involved with the business of the company are kept reasonably informed of the detail and motivations behind the scheme. In *Unilever Plc*, for example, the company made an application under the section for permission to convene a meeting of its members and to ascertain whether the scheme to buy back and reduce share capital was barred by section 641(2A) as the company sought to rationalise its international management structure.<sup>71</sup>

The section sought to prevent stamp duty avoidance which would arise on sale in a takeover, for example, only for them to be reissued in a new company, sans tax liability. The proposed Unilever scheme, which the company wished to put to its members, was effectively an amalgamation scheme of its UK and Dutch corporate structures, whereby they would be affected by share transfers, cancellations and reissues. Nugee J sought to determine the intention of the legislation as interpreted in relation to the facts before the court in the

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<sup>69</sup> *ibid*, 90.

<sup>70</sup> *Jelf Group Plc* [2015] EWHC 3857 (Ch).

<sup>71</sup> *Unilever Plc* [2018] EWHC 2546 (Ch).



Unilever scheme proposal detail, and how these facts realistically met the law.<sup>72</sup> The express motive of pursuing legitimate commercial ends of simplifying business operations rather than some underlying purpose such as tax avoidance or circumventing member rights and so bypasses the mischief prohibited by the section 641(2A) prohibition.<sup>73</sup> The scheme was approved to be put before the members, the advice of the court confirming its legitimacy, but now to be left to the operation of the scheme of arrangement process.

In the usual course of events, a company, its shareholders and creditors seek accommodation of the rights and needs of each other through compromise, both integral to schemes which therefore require exploration in terms of contextual meaning and application. Since neither 'arrangement' nor 'compromise' have any precise legal meaning, the courts have interpreted them broadly according to common usage.<sup>74</sup> In practice, therefore, virtually any difficulties faced by a company can be resolved by a 'scheme of arrangement', which has considerable flexibility and is adaptable to describe any corporate change.<sup>75</sup> Compromise is generally more difficult to achieve in a balancing of competing concerns, interests and opinions of the company and creditors, especially when there is no complete surrender or confiscation of assets.<sup>76</sup>

Company members and particularly minority shareholders, with often considerable investment in a company, will face significant risk to their influence and entitlements in the event of a substantial restructuring programme which can see their rights negotiated away.<sup>77</sup> Courts in jurisdictions such as Australia have more readily accepted and approved schemes of arrangement which alter the rights of a company's members or shareholders in the event of dispute.<sup>78</sup> This is a more controversial concession when it involves compromising company or

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<sup>72</sup> *WT Ramsay v IRC* [1981] STC 174.

<sup>73</sup> *ibid* paras 21 and 27.

<sup>74</sup> Lord Neuberger in *Lehman Brothers International (Europe) (in administration)* [2009] EWCA Civ 1161 at para 12.

<sup>75</sup> *Sneath v Valley Gold Ltd* [1893] 1 Ch 477. See also: *NFU Development Trust Ltd* [1972] 1 WLR 1548.

<sup>76</sup> *T&N Ltd and Others* [2006] EWHC 1447 (Ch).

<sup>77</sup> *Payne* (n 8) 171.

<sup>78</sup> *Opes Prime Stockbroking Limited (No 1)* (2009) 73 ACSR 385.

member rights against a third party, although in the UK context this type of schemes of arrangement has received a partial but cautious acceptance.<sup>79</sup>

Patten LJ in *Lehman Brothers* deemed it reasonable and fair that the court's jurisdiction could and should extend to approving a scheme of arrangement, in the event of a contest, which concedes to variances in the claims brought against the company by its creditors or constrains them from pursuing claims.<sup>80</sup> The court views the restriction on creditor claimants from seeking retrieval of their loan in return for shareholder concession of their own rights as "merely ancillary to the arrangement between the company and its own creditors" and not part of the substance of the scheme or its primary purpose.<sup>81</sup> This is indicative of the limitations placed on creditor entitlements, varied in the interests of the survival and promotion of the company. This is essentially a balance of fairness with the overriding principle of rescue, and in the absence of the later, the maximisation of return to creditors as a body. Administration and subsequent insolvency will leave secured creditors in a substantially improved position over those without such protection.<sup>82</sup> Strict parameters are generally defined and enforced to ensure there is a clear benefit to the company and its future. Judges must remain cautious that it is not used simply as a means by which one party to the scheme gains an advantage over another.<sup>83</sup>

The scheme is broadly viewed as a court supervised and regulated new contractual arrangement between interested parties ensuring provisions for the protection of the weaker parties. It does not include the freedom of negotiation basis of the common law commercial contract because the court must ensure it meets the statutory purpose for approval. The decisions of the court in the scheme of arrangement process are essentially an exercise in pragmatism of purpose rather than on a commercial-legal foundation. Whilst certainty of terms

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<sup>79</sup> See *Hawk Insurance Co Ltd* (n 66). For other jurisdictional approaches, see: *Metcalf and Mansfield Alternative Investments II Corp* [2008] ONCA 587.

<sup>80</sup> *Lehman Brothers International (Europe) (In Administration)* [2018] EWHC 1980 (Ch).

<sup>81</sup> *ibid* para 65.

<sup>82</sup> Bo Xie, *Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue* (Edward Elgar 2016) 30.

<sup>83</sup> Jennifer Payne, 'Schemes of Arrangement, Takeovers and Minority Shareholder Protection' (2011) 1 *Journal of Corporate Law Studies* 67, 68-71.

is a prime issue in contracts, it is occasionally absent in the reorganisation of the complex affairs of global conglomerates. However, this cannot of itself be sufficient reason for inaction.

In a subsequent judgment in the continuing *Lehman Brothers* saga, Hildyard J had to deal with competing interests in a surplus which, ironically, became apparent in administering the collapsed bank.<sup>84</sup> Such was the complexity of the international liabilities of the collapsed bank that some of them had still not been identified after 10 years of winding up the company affairs, various schemes had effected satisfaction, so far as was possible. The surplus scheme had to be implemented despite outstanding issues not being resolved that could seriously affect the entitlements that creditors had to the surplus.<sup>85</sup> After hearing evidence from objector creditors whose claims to the surplus were less strong than others, the scheme procedure afforded the Judge considerable flexibility to determine priority of claims for distribution whilst protecting the administrators from future, unknown claimants.<sup>86</sup> Where the statutory process is properly conducted and decisions are made by the statutory majority, barring evidence of a flaw in class differentiation, the court should not decline to act in approving the scheme in the face of what it considers unjustified or personally motivated objections.<sup>87</sup>

The legislation encourages judges to avoid intervening in schemes which meet the due conditions of legislative requirements. There are, however, occasions when oversight and experience prove invaluable in resolving unexpected and contentious issues which arise in the management of the affairs of an international company that has failed.

#### 2.2.5. *Jurisdiction of the UK Courts to Adjudicate on Scheme Proposals*

In the restructuring of multinational trade and service relationships, it is inevitable that jurisdictional concerns will arise, whether they be (i) the use of the UK's schemes of arrangement for corporate restructure and takeover or (ii) recognition of the new company

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<sup>84</sup> *Lehman Brothers* (n 80).

<sup>85</sup> *ibid* para 8.

<sup>86</sup> *ibid* part D(c) judgment.

<sup>87</sup> *ibid* para 109.

which emerges from the UK post-reorganisation by foreign national law and international competitors.

Where a scheme of arrangement is adopted to deal with a situation of financial distress and risk, it applies to “any company liable to be wound up under the Insolvency Act 1986”,<sup>88</sup> and normally those registered under the CA 2006, although this raises the issue of whether unregistered companies or associations can avail themselves of their utility. Indeed, limited liability partnerships are treated in the same manner as companies insofar as the IA 1986 section 53A is concerned.<sup>89</sup> This study focuses on registered corporations.

Section 221 of the IA 1986 allows the courts to wind up foreign companies that are solvent or insolvent whether registered or not. Such companies will, therefore, fall within the definition of an unregistered company. Section 221(5) of the IA 1986 does not limit the powers of the courts to dealing with foreign companies as unregistered companies provided that the company is (i) dissolved or is in the process of being dissolved so as to cease trading, (ii) it cannot discharge its liabilities, and (iii) the court considers that it is ‘just and equitable’ to wind up the company’s affairs. This qualification has allowed UK courts to adopt a broad interpretation of the requirements in section 221(5) of the IA 1986. In *Sovereign Marine & General Insurance Co Ltd* it was concluded that qualification to use the UK scheme need not require actual financial distress at the time of the scheme but the company would be subject to the English insolvency procedure should fiscal misfortune befall it.<sup>90</sup> There simply needs to be a ‘reasonable’ argument that UK courts could wind up the company and there may be parties in the jurisdiction with an interest in asset distribution in such an event.<sup>91</sup>

However, Collins J in *Drax Holdings Ltd* determined that these conditions would not necessarily be applicable to solvent companies seeking to make use of schemes of arrangement; they are

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<sup>88</sup> Companies Act 2006, Section 895(2)(b).

<sup>89</sup> Disclosure & Barring Service, *Part 5 LLPs – Compulsory Insolvency Proceedings* (February 2013) <<https://www.insolvencydirect.bis.gov.uk/technicalmanual/Ch49-60/Chapter%2053A/Part%205/Part%205.htm>> accessed 20 September 2019.

<sup>90</sup> *Sovereign Marine & General Insurance Co Ltd* [2006] EWHC 1335 (Ch).

<sup>91</sup> *Real Estate Development Co* [1991] BCLC 210 and *Latreefers Inc* [2001] BCC 174.

not mandatory to the question of jurisdiction but only exist to help judges exercise their discretion.<sup>92</sup> In *St James's Club*, the court concluded its application depended on whether the club has a structure akin to a registered company.<sup>93</sup> In determining the application of the scheme to companies not registered in the UK, *Rodenstock GmbH* the judges concluded that the phrase 'any company' in section 895 of the CA 2006 enables jurisdiction over foreign companies seeking restructure in the UK.<sup>94</sup> This is dependent on there being a 'sufficient degree of connection' between the foreign company and the UK, evidenced by asset holdings in the jurisdiction<sup>95</sup> or a 'choice of laws' clause in its trading contract, with the UK as its selection.<sup>96</sup>

It is a simple proposition that there must be some degree of connection between the foreign company and the UK in order to use its laws.<sup>97</sup> The objective is to inhibit 'forum shopping', i.e. the act of seeking a jurisdiction for scheme approval which the directors consider will be more sympathetic to their aims. The court in *NN2 Newco Ltd*,<sup>98</sup> in accepting jurisdiction over the scheme proposal of a Belgian company, which would in any case have qualified under the EU Harmonisation Directives, did note that 'good' forum shopping is more likely to be sympathetically accepted, which is where better creditor protections and outcomes are the purpose rather than the evasion of liabilities.

In the common law interpretation process of the UK legislation, broadening the authority of its courts, it remained a provision that the requesting company should at least have some operations or some assets within the UK.<sup>99</sup> However, in *Vietnam Shipbuilding Industry Groups* the High Court concluded that the fact that a company had contracts bound by English law was a sufficiently close connection to satisfy this requirement.<sup>100</sup> This is a remarkably tenuous link for which there is little doubt that any company in the international market can claim. The

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<sup>92</sup> *Drax Holding Ltd* [2003] EWHC 2743 (Ch) para 29.

<sup>93</sup> *St James's Club* (1852) 2 De GM & G 383.

<sup>94</sup> *Rodenstock GmbH* [2011] EWHC 1104 (Ch).

<sup>95</sup> *Drax Holding* (n 92).

<sup>96</sup> *Primacom Holding GmbH* [2012] EWHC 164 (Ch).

<sup>97</sup> *Rodenstock* (n 94).

<sup>98</sup> *NN2 Newco Ltd* [2019] EWHC 1917 (Ch).

<sup>99</sup> *Primacom Holding* (n 96).

<sup>100</sup> *Vietnam Shipbuilding Industry Groups* [2013] EWHC 2476 (Ch).

implication is that any dealings within the UK will facilitate access to its scheme of arrangement process. Case law simply indicates a relatively tenuous connection with the jurisdiction is necessary,<sup>101</sup> and for a transaction of this importance, it would be presumed that the restructuring company will have no difficulty in proving this. This appears somewhat simpler in the context of EU harmonisation.

In *Far East Capital Ltd SA*, a Luxembourg-incorporated group carrying on business in Russia sought sanction for a scheme of arrangement to restructure and a delay in the payment deadlines for the corporate debt of its subsidiary, The Far Eastern Shipping Company (FESCO), particularly in the Russian market.<sup>102</sup> Its shares were traded on the Irish stock market and for the purposes of the EU rules on harmonisation of jurisdictions, recognition and restructure procedure it can be described as a multilateral trading facility under EU Directive 2004/39/EC, Article 4.<sup>103</sup> The UK jurisdiction was adopted without objection by the creditors affected, and the single creditor meeting vote for the scheme was overwhelmingly positive.<sup>104</sup>

As a result of a scheme restructure, all creditors, including dissenters and non-participants, no matter where they are domiciled, are bound to the new company.<sup>105</sup> This is pertinent to recognition of the 'new' company entity across international jurisdictions, including the likes of Russia. This is a risk acknowledged in the FESCO scheme: "Although the Scheme Company has received advice that the effects of the Scheme are reasonably likely to be recognised in Luxembourg, Russia and Cyprus, there remains a risk that such effects would not be

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<sup>101</sup> *Sovereign Marine & General Insurance Co Ltd* [2006] EWHC 1335 (Ch); *NEF Telecom Co BV* [2012] EWHC 2483 (Ch); *Metrovacesa SA* [2011] EWHC 1014 (Ch).

<sup>102</sup> *Far East Capital Ltd SA* [2017] EWHC 2878 (Ch) and see FESCO, 'Scheme of Arrangement Documents: Claim No. CR-2017-007385' 22 <<https://www.fesco.ru/upload/iblock/380/explanatory-statement.pdf>> accessed 20 September 2019.

<sup>103</sup> *Far East Capital Limited*, 'Notification to Irish Stock Market' (27 October 2017) <[https://www.rns-pdf.londonstockexchange.com/rns/8773U\\_-2017-10-27.pdf](https://www.rns-pdf.londonstockexchange.com/rns/8773U_-2017-10-27.pdf)> accessed 20 September 2019 and see Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and Repealing Council Directive 93/22/EEC [2004] OJ L145/1, art 4.

<sup>104</sup> FESCO (n 102).

<sup>105</sup> *ibid* 28.

recognised".<sup>106</sup> Certainty is not an available commodity and the court must rely on the 'best advice' available based on national expertise and international relationships.<sup>107</sup>

Although the EU seeks to facilitate the process of recognition of orders made in member jurisdictions, each sovereign state retains its own ways of making law, protecting business and promoting its economy. Nevertheless, international multilateral treaties prohibit government support for companies which would result in skewed market competition. In *Agrokor D.D.*, a Croatian company faced a challenge in the UK courts to the efficacy and probity of its restructure in its domicile state.<sup>108</sup> The Croatian administration order had been made in circumstances of financial distress and impending demise of Agrokor under a national law specifically enacted to protect corporations deemed key to the Croatian economy. Challengers argued this is preferential treatment and anti-competitive, but in any case the UK courts should not recognise an order made under an 'extraordinary procedure' and it did not qualify as a 'foreign proceeding'.<sup>109</sup> The High Court decided that the conduct of foreign proceedings was a matter for the interpretation of the domicile law, namely Croatia, and it was not for the UK to impose its understanding of public policy issues on other jurisdictions. It was a decision arguably indicative of the willingness of the UK jurisdiction to accept decisions of foreign courts which are compliant with the law of that state even where they appear to overstep its legislative principles and practices.

#### 2.2.6. Member and Debtor Classification

At the first hearing, the judge's role is not to assess the merits or fairness of the proposed scheme; it is supervisory, ensuring regulatory compliance.<sup>110</sup> The court will, for example, decide how the members should be divided according to their class in relation to the voting

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<sup>106</sup> *ibid* 104.

<sup>107</sup> See also *In Avanti Communications Group Plc* [2018] 582 BR 603 (United States Bankruptcy Court, SD New York).

<sup>108</sup> *Agrokor DD* [2019] EWHC 445 (Ch).

<sup>109</sup> *ibid*.

<sup>110</sup> Ian Bloemendel, Dugan Cunningham and William Lemass, 'Members' Schemes of Arrangement – Overview of the Court Approval Process' (Clayton Utz July 2013) <<http://www.mondaq.com/australia/x/234086/court+procedure/Members+schemes+of+arrangement+overview+of+the+court+approval+process>> accessed 20 September 2019.

requirements, a complex assessment of the interests attached to a diverse range of share classifications and their comparative value.<sup>111</sup> Prior to 2001, little or no guidance was available on how voting classes should be constructed.<sup>112</sup>

This tended to create a procedural issue at the second hearing, generally a scheme approval procedure, if voters were misclassified since the court would not be able to sanction the scheme. In *Hawk Insurance*,<sup>113</sup> the judge found that the division of the creditors' classes was misguided, giving different rights to creditors even though there was insufficient diversity in voting rights to justify such allocations.<sup>114</sup> Correctly classifying voters at the earliest opportunity is evidently fundamental to ensuring efficiency throughout the scheme of arrangement process to ensure regulatory compliance. Whilst a court practice statement was issued in 2002<sup>115</sup> to aid judges in their assessment, a class is usually identified by the existence of a legal right in or against the company, such as those held by different types of shareholder.<sup>116</sup>

It must be ensured that any holder of an interest of a legal nature in the outcome will have time to examine how it might impact on their rights. Not all stakeholders may be affected by a focused scheme restructure and directors have a tactical discretion to seek to exclude creditors who may reject a proposal which affects their interests.<sup>117</sup> Indeed, at least in principle, it need not even consult with any creditor whose rights are not affected by the scheme of arrangement.<sup>118</sup> The company may also prevent less influential beneficial interest holders from exercising their entitlements at law.<sup>119</sup> If a scheme of arrangement falls under the CA 2006 and does not concern insolvency, it may severely limit creditors' rights, binding dissentient creditors

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<sup>111</sup> David Milman, 'Schemes of Arrangement and Other Restructuring Regimes under UK Company Law in Context' (2011) 301 Sweet and Maxwell's Company Law Newsletter 1, 1-4.

<sup>112</sup> For example, *Hellenic and General Trust Ltd* [1976] 1 WLR 123.

<sup>113</sup> *Hawk Insurance Co Ltd* (n 66).

<sup>114</sup> Henry Gibbon and Quentin Carruthers, *Corporate Restructuring: The Breaking Wave* (IFR 2015) 104.

<sup>115</sup> White Book, 'Practice Statement: Companies: Schemes of Arrangement' [2002] 1 WLR 1345.

<sup>116</sup> *Cumbrian Newspapers Group Ltd v Cumberland & Westmoreland Printing Ltd* [1987] Ch 1.

<sup>117</sup> *Bluebrook Ltd* [2009] EWHC 2114 (Ch).

<sup>118</sup> Payne (n 8) 43.

<sup>119</sup> Simon Goulding, *Principles of Company Law* (Routledge 2013) 268.



to the favourable majority vote.<sup>120</sup> Creditors may be side-lined as parties to the scheme negotiations but, depending on class allocation by the court, but not as voters; the judge is the arbiter of fairness in procedure.<sup>121</sup>

The options for company management in the pursuit of reorganisation, even in terms of whom they wish to consult, negotiate or even involve, carry significant flexibility. The court on the initial presentation of the agreement must ensure fairness at least in the provisions of the plan and its detail. The chosen tactics of the corporate approach to a restructure scheme are particularly important when a number of senior and junior creditors are involved and whose interests are affected by negotiations. *Bluebrook Ltd* involved a senior debt value of £313 million, with £119 million owed to lesser creditors for value. The decision of the court to approve the proposed scheme was predicated on the substantial difference between the interests, and the fact that the benefit accrued to the senior creditors far outweighed the loss to their lesser creditor counterparts.<sup>122</sup> Discretionary judicial fairness was weighted in favour of the company while it remained solvent but in need of reorganisation of its liabilities by scheme. This is essentially an act of good faith on the part of the directors to promote the success of the company, as per section 172 of the CA 2006, rather than to protect the interests of the body of creditors. The court will determine fairness in this event given that it effectively prevents lesser creditors from enforcing their entitlement. This is a departure from the effects of the administration process whereby, under Schedule B1 of the IA 1986, the interests of all creditors must be taken into account in asset distribution.<sup>123</sup>

It raises questions about how the long-term interests of smaller creditors can be protected if they are involved in companies with stakeholders carrying substantially more influence;

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<sup>120</sup> Slaughter and May, 'The International Insolvency Review: UK Insolvency Law' (Slaughter and May November 2013) 14 <<https://www.slaughterandmay.com/media/2050696/the-international-insolvency-review-uk-insolvency-law.pdf>> accessed 20 September 2019.

<sup>121</sup> *ibid* 14.

<sup>122</sup> *Bluebrook Ltd* [2009] EWHC 2114 (Ch)

<sup>123</sup> Rizwaan Jameel Mokal, 'Priority as Pathology: The Pari Passu Myth' (2001) 60(3) Cambridge Law Journal 581, 582.

essentially, it raises the risk of a ‘tyranny of the majority’<sup>124</sup> which the courts must approve if procedurally justifiable. The company will determine priorities of rights preservation and surrender, and the balance of competing stakeholder interests in the context of corporate reorganisation, depending on the market and the commercially astute approach of the courts.<sup>125</sup> The approval of a scheme of arrangement will certainly impact on the projected, and therefore somewhat speculative, medium to long-term direction and success of a company.

In addition to deciding who should be entitled to vote on a scheme of arrangement, the courts have wide discretion in determining the terms on which the corporate restructuring meeting will place, including whether it is necessary to have one or several general or class meetings to consider the proposed scheme of arrangement. In *Sovereign Life Assurance Co v Dodd*, for example, upon reaching a definition of the ‘class’ proposed to be integral to the restructure, the company may exclude other stakeholders where that part of the process does not adversely affect their interests.<sup>126</sup>

### 2.2.7. Potential of Classification of Rights to Obstruction of the Scheme

Taking the view that a class is a group of people with common interests, the reasonable expectation is that they can discuss the scheme amongst themselves and arrive at a conclusion which encapsulates and articulates that common interest.<sup>127</sup> It is not a statutory prescription but a practice developed by the court to ensure regulatory compliance and the opportunity of airing the views of all interested bodies. A balancing exercise is therefore conducted by the court to ensure that different classes are afforded equal protection by allowing them to hold their own meetings to discuss the implications of the proposed scheme for their joint interests.<sup>128</sup> If it fails to meet their needs, this dissenting opinion needs to be articulated to the court. Classification of creditors is perceived as an advantage the scheme has over, for example,

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<sup>124</sup> John Stuart Mill, *On Liberty* (1859).

<sup>125</sup> *Pilkington* (n 10) 45-46.

<sup>126</sup> [1892] 2 QB 573, 583.

<sup>127</sup> *ibid* 583.

<sup>128</sup> Sarah Worthington, *Sealy and Worthington's Text, Cases, and Materials in Company Law* (Oxford University Press 2016) 786.

the CVA, a respondent to the PwC Business Survey 2010 noting the latter process needs improvement; “we need clarification on how far a CVA can go when differentiating treatment of creditors; and clarification on distinguishing between classes; but at least a court is necessarily involved in sanctioning a scheme, whereas the onus is on an unhappy creditor in a CVA to challenge it, which isn’t very fair.”<sup>129</sup> It is however also considered a problematic complication to the scheme process.

The effect of several meetings of different classes should not be underestimated in terms of impact on the approval of a scheme of arrangement and corporate reorganisation as this may provide a basis for giving minority creditors a veto over the majority. The first stage of the warning comes from Nourse J, in *Anglo American Insurance*, in terms of the classification process: “if one gets too picky about potential different classes, one could end up with virtually as many classes as there are members of a particular group”.<sup>130</sup> In *BTR Plc*, Parker J asserted that only members with different rights could form a separate class, as opposed to those with different interests.<sup>131</sup> Thus, for example, the quantity of company shares held by individual shareholders may vary considerably and it could be argued that while they form their own class, their best interests may differ considerably *vis-à-vis* the proposed scheme of arrangement and they may not be able or willing to assume one united position.

The test of class had been originally formulated in *Sovereign Life* but was refined in *Hawk Insurance*<sup>132</sup> in which it was determined the rights that were subject to release or variation and the new entitlements, if any, that would replace them in the compromise.<sup>133</sup> In deciding therefore whether separate meetings must be held for different classes, the court needs to focus on assessing the degree of similarity in the rights and interests of those involved so as to

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<sup>129</sup> Business Recovery Services, ‘Schemes and CVAs – the perfect arrangement?’ (PwC Law Survey April 2010) <https://www.pwc.co.uk/assets/pdf/schemes-and-cvas.pdf>> 13.

<sup>130</sup> *Anglo American Insurance Co Ltd* [2001] 1 BCLC 755, para 764.

<sup>131</sup> [1999] 2 BCLC 675.

<sup>132</sup> [2001] EWCA Civ 241.

<sup>133</sup> *ibid* para 30.

work out which are sufficiently similar.<sup>134</sup> According to Chadwick LJ in *Hawk Insurance*, an appropriate question to ask is whether a scheme deals with the interests of all creditors, or should there be a series of related arrangements to meet diverse entitlements.<sup>135</sup> It is not suggested that shareholders attending class meetings will vote *en bloc*, nor are they are likely to only because of aims and personality. Where money is concerned, it is reasonable to presume that shareholders will vote according to what they perceive as their best investment interests, dictated by the number of shares that they hold.<sup>136</sup>

Large companies will generally issue different types of shares with distinctive voting powers and rights. Chadwick LJ, in *Hawk Insurance*, compared all creditor share rights at the time that the company was being wound up and decided that they carried the same rights in dissolution so differentiation was not pertinent to the result. In *British Aviation Insurance Co Ltd*, the company that was solvent at the point when a scheme of arrangement was being considered to restructure its affairs and liabilities, and, in that context, creditors were to be treated in different ways and should thus be classified on the effect on rights into separate meeting groups.<sup>137</sup>

The courts evidently have a broad discretion, and they exercise these according to what they believe is fair and will work effectively, on how the notification and hearing of diverse interests and rights are to be heard, depending on the facts of the scheme plan and those affected by it. At no stage, however, should this facilitate obstruction, given the purpose of Part 26 of the CA 2006 legislation. In *Dee Valley Group Plc*, the judges refused to allow a plan proposal to be split as that would have effectively prevented the proposal from succeeding.<sup>138</sup>

Rights, particularly those affecting voting entitlement, are more easily discerned than interests when identifying potential classes and the need for separate meetings. Indeed, fewer classes

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<sup>134</sup> O’Dea, Long and Smyth (n 11) 89-91; Richard Sykes, ‘Schemes of Arrangement: The *Hawk* that Muddied the Waters’ (Practical Law 29 May 2001) <<https://uk.practicallaw.thomsonreuters.com/9-101-4775?transitionType=Default&contextData=%28sc.Default%29>> accessed 20 September 2019.

<sup>135</sup> *Hawk Insurance* (n 132), para 23.

<sup>136</sup> BTR Plc [1999] 2 BCLC 682-683.

<sup>137</sup> [2005] EWHC 1621 (Ch).

<sup>138</sup> [2017] EWHC 184 (Ch).

may make it somewhat easier for schemes of arrangement to be voted through and ultimately the court is likely to accept the majority perception of the best interests of the company over protection of minority creditors. It expedites reorganisation, particularly important where urgent action is demanded.

Pragmatism aids improvement of prospects of reorganisation or an orderly demise. In *House of Fraser*, Birss J determined that when financial distress makes reorganisation a matter of urgency, the class allocation comparator for creditor priority is insolvency, which is a potential result if the scheme is unsuccessful. Debt maturity and liability for payment would become effective on the same date, making forward financial planning and class differentiation a somewhat academic exercise.<sup>139</sup> Otherwise diverse creditor interests tend to melt into statutory priority of distribution. From a commercial point of view, rather than one based strictly on legal rights, there was anticipated to be no effective, calculable difference in return to the creditors as a collective, and thus no requirement to differentiate between them.<sup>140</sup> It would, therefore, be a fruitless exercise to draw up and divide it into a class based differentiation. It would also be time-consuming and an unnecessary expense.

Rights indeed may be evaluated on a basis of potential impact on the scheme decision. In *Zodiac*, an objection by a creditor who wished to have subsidiary agreements with the company considered separately raised an objection to a single class being determined for insolvency scheme consideration.<sup>141</sup> Morgan J determined that ‘connected creditors’, those with additional sub-participation and others with a revolving credit facility constituted creditor interests, not rights, and were not entitled to separate consideration from the single body of otherwise competing creditors.<sup>142</sup> It is suggested that to have allowed the application would have introduced ancillary points to the main scheme proposals and that a ‘class of one’ should

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<sup>139</sup> *House of Fraser (Funding) Limited* [2018] EWHC 1906 (Ch), paras 20-22.

<sup>140</sup> *ibid* para 25.

<sup>141</sup> *Zodiac Pool Solutions SAS* [2014] EWHC 2365 (Ch).

<sup>142</sup> Gabriel Moss and Adam Goodison, ‘Re Zodiac Pool Solutions SAS [2014] EWHC 2365 (Ch)’ (2014) South Square Digest 24.

not be approved to effectively raise legal costs and consume time, the latter being a particularly precious commodity in the circumstances.

The meeting of company stakeholders' stage, monitored by the court, having been completed, the restructure plan is then put to the creditor vote, approval requiring at least the support of three-quarters of the value of creditor entitlement. It is the holders of 50% of the corporate debt who carry the vote, not the numbers of persons or institutions. This is a relatively uncontroversial exercise in mathematics as creditors simply vote according to their own interests and rights. In the court sanctioning process the CA 2006 does not contain any guidance concerning the factors that the court should take into account when reaching its decision, especially in the face of challenges.

Nevertheless, where all the procedural elements have been duly complied with, the court may exercise its discretion on approval of the final proposed scheme of arrangement.<sup>143</sup> It must (i) confirm it has jurisdiction to approve the agreement and (ii) that the particular facts of the case justify the planned restructure in the manner proposed. Although the second provision suggests a court assessment of the efficacy of the scheme, the court will not, generally, impose its will on a negotiated agreement, as per *Uniq Plc*. Neither of these steps should be contentious given the process of supervision and the reorganised company will be registered at Companies House, binding on all stakeholders and its revised formulation recognised in the market.

### **2.3. Schemes of Arrangement as a Debt Restructuring Mechanism**

Schemes of arrangement have at least three core strengths in terms of their ability to support company restructuring processes. First is their flexibility of operation since they can be adapted to meet the needs of companies, their creditors and members. This is credited to the common law system and the practical approach followed by the English courts.<sup>144</sup> They can be combined

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<sup>143</sup> *Scottish Lion Insurance Co Ltd v Goodrich Corp* [2009] CSIH 6.

<sup>144</sup> Christopher Mallon and Shai Waisman, *The Law and Practice of Restructuring in the UK and US* (Oxford University Press 2011) 5.

with other debt-resolution mechanisms and used to target specific aspects of a company's financial difficulties since the court will afford some commercially based latitude.

The second virtue of the scheme, in the absence of fraud, is that once agreed, the interested, affected parties are able to be involved in the future planning through conciliation of resolving corporate problems, whether financial or structural.<sup>145</sup> Third, majority support from the company's creditors or members, sanctioned by the courts, makes the new arrangement binding upon the remaining minority of creditors or members. It prevents minority creditors, creditors with security or other members from impeding the company's long-term future.<sup>146</sup>

The financial restructure purpose of the scheme need not be reserved for times of distress but is acutely important for adaptation to market volatility, business expansion and the securitising of the fiscal future of the company. The altering of liabilities, payment terms and deadlines and indeed exchange of debt for equity plans are just some of the options which can be effected by scheme of arrangement which can fundamentally alter relationships with the company and its operations, especially in the global environment.<sup>147</sup> Simple debt avoidance is not a sensible, reputable business practice. With the monitoring of the scheme plan by the UK courts and the onerous procedural demand of the legislation process, international credibility, veracity and trust can be preserved for the relatively new emergent financial structures.<sup>148</sup>

Its flexibility enables adaptation to changes of law which affect business practice, but it does not undermine stability or the corporate structure *per se*. This is exemplified by the actions of *Royal London*<sup>149</sup> in their management of the government's 'Pensions Freedom' policy that allows investors to 'cash-in' their policies, discarding guaranteed, tax efficient annuity rates

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<sup>145</sup> Bo Xie, *Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue* (Edward Elgar 2016) 54.

<sup>146</sup> Gerard McCormack, *Corporate Rescue Law – An Anglo-American Perspective* (Edward Elgar 2008) 70.

<sup>147</sup> Chris Howard, 'Law and Practice UK' (Sullivan and Cromwell LLP 2014) 558 and seq, <[https://www.sullcrom.com/files/upload/Insolvency\\_UK\\_Chapter.pdf](https://www.sullcrom.com/files/upload/Insolvency_UK_Chapter.pdf)> accessed 20 September 2019.

<sup>148</sup> *ibid*, 570 and seq.

<sup>149</sup> *Royal London* (n 45).

(GAR).<sup>150</sup> In a scheme designed to support its policyholders, supported with accountancy, actuarial and legal advice, standards of service and practice were presented to the court regarding provision of an advisory scheme and the payment of a bonus to those who sacrificed their guarantees to ameliorate their potential loss of future retirement stability.<sup>151</sup> Essentially, the scheme process had proven itself not simply useful and flexible but desirable when companies faced substantial legal conundrums to the way they did business.

The scheme of arrangement does however have some inherent weaknesses, the first somewhat ironically arising from its strength in flexibility and dependence on consent of creditors. This concern is met and ameliorated somewhat by comparison with other restructuring mechanisms.<sup>152</sup> It has been noted that much justification must be presented to the court in the matters of what stakeholder interest and rights are required to be taken account of, unlike the CVA and Administration as insolvency proceedings.<sup>153</sup>

A further disadvantage for small companies is that schemes can be expensive, complex and cumbersome in their procedural needs, from those of the diverse expertise of accounting and legal professionals in preparation of plans to the time expended in preparation and negotiation of terms of the agreement, not forgetting at least two court appearances.<sup>154</sup> This is particularly the case where a company is insolvent given that it depletes resources and assets in rescue which may have to be available to creditors in liquidation should the scheme fail. Arguably for larger insolvent companies the expense may be more justifiable to cram down contentious interests and creditors, legitimising the removal of obstacles to rescue.

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<sup>150</sup> Charles Walmsley, 'Royal London Gets Go-ahead to Cash in Annuity Guarantees' (CityWire 26 April 2018) <<https://citywire.co.uk/new-model-adviser/news/royal-london-gets-go-ahead-to-cash-in-annuity-guarantees/a1113907>> accessed 20 September 2019.

<sup>151</sup> Deloitte, 'Report of the Independent Actuary on the Royal London (Scottish Life) GAR Compromise Scheme' (Deloitte MCS Limited 2018) <<https://www.royallondon.com/globalassets/docs/consumer/gar/talisker-independent-actuary-report.pdf>> accessed 20 September 2019.

<sup>152</sup> Payne (n 8) 104.

<sup>153</sup> Business Recovery Services (n 129), 16.

<sup>154</sup> Payne (n 8), 6.



A moratorium, a ‘breathing space’ where creditors are prevented from legal action against its debtor, would be of value to assessment of the prospects of survival should the company have sufficient funds to legitimately continue operations and “the right balance is struck between debtors’, creditors’ and suppliers’ rights”.<sup>155</sup> The Insolvency Service considers it will allow time for companies to “explore options which will best deliver a successful rescue where possible”.<sup>156</sup> It proposes a three month restructuring period which respite from civil actions will enable faster, cheaper reorganisation practices for companies with complex debt problems to effect negotiations and, importantly for directors, remove the risk of liability for continued trading where conditions are complied with.<sup>157</sup> The current lack of a moratorium means that schemes are often bundled up with company administration, identified in the Insolvency Service’s consultation in 2016 as being a significant factor influencing, and undermining, the usefulness of schemes of arrangement.<sup>158</sup> The government response published in August 2018 indicates some wariness in how to introduce the option to suspend creditor enforcement. It should not automatically apply in a restructure process but be requested of the court with strict conditions on duration and operation in order to ensure that creditor rights are supervised and protected.<sup>159</sup>

Although plans appear to be in consideration for an effective moratorium provision, coupled with a more robust cross-class cram-down process which inhibits resistance to restructure and rescue, Paterson and Pink point out that there is no clear statement of government policy to

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<sup>155</sup> Jennifer Payne, ‘A New UK Debt Restructuring Regime? A Critique of the Insolvency Service’s Consultation Paper – Part 1’ (Oxford Business Law Blog 14 June 2016) <<https://www.law.ox.ac.uk/business-law-blog/blog/2016/06/new-uk-debt-restructuring-regime-critique-insolvency-service%E2%80%99s>> accessed 20 September 2019.

<sup>156</sup> The Insolvency Service, *A Review of the Corporate Insolvency Framework: A Consultation on Options for Reform* (25 May 2016). See also, The Insolvency Service, *Summary of Responses: A Review of the Corporate Insolvency Framework* (HMSO 2016) 9.

<sup>157</sup> *ibid*

<sup>158</sup> *ibid*

<sup>159</sup> See Section 5 of the BEIS, *Government response: Insolvency and Corporate Governance* (26 August 2018) <<https://www.gov.uk/government/consultations/insolvency-and-corporate-governance>> accessed 20 September 2019.

support their introduction.<sup>160</sup> In its absence, it is argued that, on a transplantation issue, the UK may be adopting law from other jurisdictions simply because it appears to work. They have indeed been shown to be valued mechanisms toward company rescue, although they tip the balance from a traditional creditor-friendly perspective of UK law to a stronger corporate protection focus.

Schemes of arrangement offer distinct advantages as a flexible mechanism that allows companies to engage with their creditors to manage their financial difficulties. They have inherent complexities and supervisory requirements which mean they do not provide a simple solution for all problems, without considerable imagination, foresight and hope. It does not have the stigma of bankruptcy, nor does it require the appointment of a court accountable insolvency practitioner. It allows directors greater control over the reorganisation of the company and negotiations pertinent to its rescue and promotion. It is inherently more flexible in purpose than restructure, without the need for financial distress or bankruptcy, than alternative methods of resolving the latter problems, such as CVAs or administration, provided that the directors have been astute enough to recognise impending issues.<sup>161</sup>

Nevertheless, much will depend on the extent of fiscal distress. Companies which have strained financial circumstances but are not at insolvency risk may be more inclined to elect the CVA procedure. This is particularly so when non-secured creditors are amenable to negotiation for delayed repayment, thus avoiding the administrative procedures of schemes, although the CVA lacks ability to compromise secured debt.<sup>162</sup> The need for an administration process, which leads to loss of director control and management of assets, is likely anathema to such companies which are still viable and functioning.

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<sup>160</sup> Sarah Paterson and Michael Pink, 'Wrangling Reform into the Insolvency Toolbox' (Recovery Legal Update Summer 2019) 15.

<sup>161</sup> Christopher Mallon, Alex Rogan and Sebastian Way, 'Chapter 8: England and Wales' in Mallon C (ed), *The Restructuring Review, Ninth Edition* (Law Business Research Ltd, 2016) 98.

<sup>162</sup> Business Recovery Services (n 129), 8.

## 2.4. Schemes of Arrangement in Contemporary Times

It is proposed now to examine the use of schemes of arrangement in effecting corporate reorganisation beyond their origin as a means to deal with insolvency. It has been noted in this chapter that their utility, approved by the courts, includes, for example, those companies performing more dynamic and expansive practices of merger, takeover and acquisition in the UK market. Although the scheme of arrangement has a statutory basis, its utility is not prescribed or limited in terms of corporate restructure, accommodating diverse forms of substantial change in operation.

### 2.4.1. The Use of Schemes of Arrangement to Effect Company Takeovers

The focus for now is on the use of schemes of arrangement to effect takeover of another corporate entity, be it a competitor or for entry into a new market. The scheme of arrangement has a considerably broader value to companies in their adaptation to market change than simply dealing with financial risk and distress. This is a non-debt, non-distress, related restructuring process. It is an alternative to the other procedures of entering into negotiations to buy a company through direct dealing with shareholders or stock market intervention.<sup>163</sup> It has significant public and commercial benefits, often in the enhancement of investor value and in the avoidance of foreseeable disadvantageous changes in the market.

It is an evolution of the scheme beyond dealing with financial issues and even at the end of the 19<sup>th</sup> Century raised questions of its appropriateness for that purpose given established traditional practices. In *City of Melbourne Bank Ltd (in liquidation)*, the Australian High Court adjudicated that the law was sufficiently broad to allow liquid companies to use the method to restructure their operations.<sup>164</sup> Section 24 of the Companies Act 1900 specifically allowed schemes of arrangement to be used by members to carry out reorganisation of their company, clarified by section 38 of the Companies Act 1907 that liquidation need not be an issue. They

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<sup>163</sup> Ibne Hassan and Pervez Ghauri, *Evaluating Companies for Mergers and Acquisitions* (Emerald Group Publishing 2014) 22.

<sup>164</sup> (1897) 19 ALT 80, para 382 (another Australian case).

were somewhat erroneously called ‘member schemes’ because it was considered that the member of the company were the drivers of the arrangements rather than creditors, but in the context of a takeover the approval of the latter was generally necessary and negotiated. It is a company law procedure, not insolvency.

Section 895 of the CA 2006 defines the modern scheme, proposed by a company or its members in any circumstance so long as there is compliance with the regulatory formalities. The purpose of its formulation is of less importance provided it does what it states it has been prepared for; if it looks like a scheme, it will be considered a scheme. In *Savoy Hotel Ltd*,<sup>165</sup> for example, an arrangement was *prima facie* constituted a scheme, and was subject to the statutory regulatory process even where it was never intended to be a scheme of arrangement. Nourse J relied in his judgment on *Singer Manufacturing Co v Robinow*<sup>166</sup> to opine that for a scheme to be valid as a takeover instrument, its central purpose must actually be a takeover, not for example to oust management or bothersome internal factions.

The City Code on Takeovers and Mergers goes further in demanding transparency, as per section 3(a), that schemes of arrangement are to be considered and termed as such if they are being used as the basis to effect a takeover.<sup>167</sup> Their more common utility should not be interpreted as more facilitating of the takeover of another company than the traditional methods, given that the High Court enforces a strictly regulated timetable upon the parties involved in the takeover or merger via the scheme method.<sup>168</sup> The EU Takeover Directive 2004/25/EC recommends that the law of Member States “should be flexible and capable of dealing with new circumstances as they arise and should accordingly provide for the possibility

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<sup>165</sup> [1981] Ch 351.

<sup>166</sup> [1971] SC 11.

<sup>167</sup> Panel on Takeovers and Mergers, ‘The Takeover Code’ (2016) <<http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf?v=8Jan2018>> accessed 20 September 2019.

<sup>168</sup> Slaughter and May, ‘A Guide to Takeovers in the United Kingdom’ (November 2018) 9 <<https://www.slaughterandmay.com/media/39320/a-guide-to-takeovers-in-the-united-kingdom.pdf>> accessed 20 September 2019.

of exceptions and derogations” while meeting monitored standards of minority and creditor protection and fairness of a regulated procedure.<sup>169</sup>

There is also no statutory definition of a ‘member’ in the CA 2006, who has the potential for determining entitlement to propose the restructure scheme. Section 112 makes a limited contribution to the lexicon:

“(1) The subscribers of a company's memorandum are deemed to have agreed to become members of the company, and on its registration become members and must be entered as such in its register of members and

(2) Every other person who agrees to become a member of a company, and whose name is entered in its register of members, is a member of the company.”

Where the company is registered in the UK, then it would seem logical to suggest that the term ‘member’ refers to the shareholders. Given the registration requirements of the Act, individuals who could become company shareholders, such as those holding security options capable of being converted into shares, would not yet be considered members for the purposes of a scheme of arrangement.<sup>170</sup> Nevertheless, the courts tend to adopt a wide definition of a company’s members for the purposes of scheme of arrangement proposal and adoption, and those who hold securities, rather than share membership, can be considered members, entitling them to vote on the scheme proposal.<sup>171</sup>

Given the benefit-obstacle balance of schemes in a takeover context, the process becomes a comparative choice of mechanism with share purchase negotiations and market intervention. The UK Takeover Panel noted that “in the year ended March 2002 around 10% of offers regulated by the Panel were effected through schemes; in the year ended March 2008, the equivalent figure was 41%”.<sup>172</sup> No reason was given by the Panel for this development but it

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<sup>169</sup> Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids [2014] OJ L142/12.

<sup>170</sup> *Compania de Electricidad de la Provincia de Buenos Aires Ltd* [1980] 1 Ch 146, para 183.

<sup>171</sup> *Lehman Brothers* (n 74).

<sup>172</sup> Takeover Panel, *Annual Report and Accounts for the Year Ended 31 March 2008* (2009) 13.

did note that significant factors in the code are often included in scheme particulars, preserving its principles in a 'market practice' where schemes continue to develop.<sup>173</sup>

#### 2.4.2. *Comparative Advantages of Schemes of Arrangement*

Perhaps the growing popularity amongst companies and lawyers of the schemes of arrangement is that they offer a simplified, easily managed and independently supervised approach to the takeover process than other established mechanisms. The initial point of note is that effecting a takeover of another corporate entity through a member scheme, essentially a management proposal, is similar to that availed of by a creditor. The process for the takeover scheme, similar to that employed in dealing with financial distress, is proposed by the company, generally drafted by the board and an application made to the court pursuant to section 896 of the CA 2006 presenting intention and the plan.<sup>174</sup>

The High Court will approve the scheme, provided it has sufficient clarity of purpose, detail and advice on the notification process for members to meet as a body or by defined class to discuss and adjudge acceptance or rejection of the plan to a special majority of 75% of affected classes of members.<sup>175</sup> On the court's approval, the registration formalities of the new entity are undertaken and the legal requirements for the new entity fulfilled.<sup>176</sup> It will only be set aside on evidence of fraud.

Davis describes the operation of the scheme of arrangement based corporate takeover process as initiated by members and the board of either the acquiring or of the target company rather than the creditors of either.<sup>177</sup> The shares in the target are transferred in return for cash or securities. This is essentially the same process as the traditional takeover but it "takes effect as a result of the court order approving the scheme, not by way of contract"<sup>178</sup> and has more

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<sup>173</sup> *ibid*

<sup>174</sup> Pilkington (n 10) 45-47.

<sup>175</sup> Companies Act 2006, Section 899(1).

<sup>176</sup> *ibid* Section 899(4).

<sup>177</sup> Paul Davies, 'The Transactional Scope of Takeover Law' in Umakanth Varottil and Wai Yee Wan (eds), *Comparative Takeover Regulation: Global and Asian Perspectives* (Cambridge University Press 2017) 89.

<sup>178</sup> *ibid* 90.

favourable tax accountability benefits, which do not form a part of this study.<sup>179</sup> The target company makes the ownership changes to the registration documents.

Concerns have been raised that using the schemes, with the superior power of the requisite majority, undermines the protection of minority rights incorporated in the traditional takeover process. When comparing the operation of schemes, the UK Takeover Code regulations and the need for reform, Wang and Lahr asserted there must be ‘an optimal set of rules’ that balances the promotion of corporate control and protection of minority shareholder interests from bidders, majority shareholders or their own management.<sup>180</sup> Nevertheless, schemes of arrangement, compliant with regulatory procedures, will generally be approved by the court to the cost of the less influential stakeholders, members and creditors.

In the traditional takeover procedure, the bidder-acquirer will directly negotiate with shareholders of the target company.<sup>181</sup> It will not necessarily involve any discourse with the target company management who may be resistant to a takeover that they consider to be hostile “and not therefore amenable to the persuasion of the scheme of arrangement”.<sup>182</sup> A rather impersonal exercise conducted through the stock market with no contact with any shareholder, it generally results in a shift of management to the bidder-acquirer.<sup>183</sup> Article 3 of the EU Takeover Directive, entered into UK law via the Takeover Code under CA 2006, does however require the protection of other share and securities holders, allowing them sufficient time to consider the implications for the company and its operations, and make an informed decision on support or otherwise.<sup>184</sup> Views on the takeover are expressed in a General Meeting of shareholders, per Article 12.

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<sup>179</sup> *ibid.*

<sup>180</sup> Ying Wang and Henry Lahr, ‘Takeover Law to Protect Shareholders: Increasing Efficiency or Merely Redistributing Gains?’ (Centre for Business Research, University of Cambridge Working Paper No 486 December 2016) 6 <[https://www.cbr.cam.ac.uk/fileadmin/user\\_upload/centre-for-business-research/downloads/working-papers/wp486.pdf](https://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp486.pdf)> accessed 20 September 2019.

<sup>181</sup> Davies (n 177) 97.

<sup>182</sup> Athanasios Koulouridas, *The Law and Economics of Takeovers: An Acquirer's Perspective* (Hart 2008) 51.

<sup>183</sup> Ulrich Immenga, ‘Company Systems and Affiliation’ in *International Encyclopedia of Comparative Law*, Vol Xiii (International Association of Legal Sciences 2007) 15.

<sup>184</sup> Directive 2004/25/EC (n 169), art 3.

The target company directors must always bear in mind their duty, under section 172 of the CA 2006, to act in the best interests of the company. However, under Article 9 Takeover Directive 2004/25/EC, they must also remain neutral unless they have the voting support of the shareholders to resist.<sup>185</sup> They may still seek another more favourable bidder but this would lack the control that it would normally have in a scheme arrangement negotiation. The Directive does not apply to schemes of arrangement and actually has a relatively more complex set of rules for how a company is to be acquired. This covers factors such as offer conditions, time limits and communication needs, which appear not to be conducive to a more compromising arrangement of the business.<sup>186</sup>

The takeover requirement will be activated by the bidder-acquirer purchasing in excess of 30% of the shares and voting rights as per Rule 9 of the City Code on Takeovers and Mergers.<sup>187</sup> This loss of control by directors, in accompaniment with the neutrality rule, can be avoided if the predator company is amenable to negotiation of a scheme of arrangement. The takeover process requires a simple majority support but minority shareholders who simply do not wish to sell their holding are entitled to considerably more protection of their interests than under a scheme.<sup>188</sup>

This places considerably more power in the hands of the dissenting minority to frustrate the takeover process than the scheme of arrangement regulations, perhaps explaining the growing popularity of the scheme of arrangement method. The traditional bidder-acquisition takeover carries an inherent risk that some shareholders will attempt to slow down the process.<sup>189</sup> Schemes will ensure that the bidder takes over 100% of the target company as long as at least the lower threshold of 75% of members' votes in favour of the arrangement. In the traditional takeover mechanisms, the bidder must reach a 90% threshold to squeeze out dissenters and

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<sup>185</sup> *ibid* art 9.

<sup>186</sup> *ibid*.

<sup>187</sup> Panel on Takeovers and Mergers, 'The Takeover Code' (2016) <<http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf?v=8Jan2018>> accessed 20 September 2019.

<sup>188</sup> Worthington (n 128) 802.

<sup>189</sup> Janet Dine and Marios Koutsias, *Company Law* (Macmillan International Higher Education 2014) 233.



compel sale in order to obtain total ownership.<sup>190</sup> The scheme will further assist in resolving take-over difficulties which arise not just as a result of resistance, but the fact that shareholders are untraceable.<sup>191</sup> Again, as long as 75% of the members vote in favour of a members' scheme, the bidder will be able to legally acquire the title to all shares.

Taxation advantages also follow the scheme process. Whilst stamp duty is payable on transfer, this is avoidable by implementing a 'cancellation scheme' whereupon payment is made, the original shares cancelled and new ones issue to the acquiring company.<sup>192</sup> Where the target company has US-based shareholders, a takeover is likely to be subject to securities exchange regulations, increasing taxation liabilities and legal regulatory compliance per US Securities Act 1933.<sup>193</sup> In such circumstances, a member's scheme of arrangement would avoid the statutory liabilities and save significant time and expense in the process.<sup>194</sup>

In member schemes of arrangement the target company retains control over the takeover process since it tends to initiate the takeover process because it has what the bidder wants, perhaps an intellectual property complement or other asset benefit. The likelihood of contest or hostility in the relationship with the acquirer is reduced by the conciliatory process, thus easing the takeover and reducing costs and risks of transactional failure.<sup>195</sup> It is also more media friendly, vital to retention of reputation in the marketplace. This contrasts with the traditional method where the bidder controls the providing of information to the shareholders.

Further, the traditional takeover process will not, generally, require the input of court oversight, provided it is compliant with the Code regulatory process. The scheme of arrangement is, by contrast, a mechanism with strict timelines for court hearings and voting.

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<sup>190</sup> Greg N Gregoriou and Luc Renneboog, *Corporate Governance and Regulatory Impact on Mergers and Acquisitions: Research and Analysis on Activity Worldwide Since 1990* (Elsevier 2007) 223.

<sup>191</sup> *ibid.*

<sup>192</sup> Daniel Klineberg, 'Corporate Schemes – Versatile and Effective' (2007) 4 *Butterworths Journal of International Banking and Financial Law* 226, 230-235.

<sup>193</sup> Kenneth J Lebrun and Daniel Litowitz, 'Public Mergers and Acquisitions in the United States: Overview' (Shearman and Sterling LLP 2017) <[https://uk.practicallaw.thomsonreuters.com/2-501-9729?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/2-501-9729?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1)> accessed 20 September 2019.

<sup>194</sup> Neeti Shikha, 'Takeover through Scheme of Arrangement: A Changing Trend in UK' (2013) 38(1) *Vikalpa* 98.

<sup>195</sup> Brenda Hannigan, *Company Law* (Oxford University Press 2012) 682.

This makes the schemes potentially time consuming to effect than the traditional bidding process, problematic when there is a degree of urgency necessary to, for example, ameliorate financial difficulties of either party. Nevertheless, English courts do not readily interfere in the scheme process, which makes it attractive to foreign companies as they may be inclined to move their operations to the UK in order to benefit from UK laws. This may however be a 'paper exercise' with no tangible benefits to the UK economy other than charging legal fees.<sup>196</sup> The operation of schemes of arrangement is a valued alternative to the execution of a takeover, especially in those circumstances where there are difficult shareholders who might not be willing to sell their holding.

#### 2.4.3. Procedural Issues in Approving a Takeover Scheme of Arrangement

The supervisory procedure for schemes of arrangement emphasises the role of the High Court in contexts where the target company does not consent to the process. In *Savoy Hotel*, it was considered appropriate at the first hearing to allow a meeting about the proposal to be held but at the second hearing it was not possible for the court to approve a scheme of arrangement without the majority approvals required to proceed with the process.<sup>197</sup> There is no automatic entitlement to have the court order a meeting. The scheme is not particularly appropriate where does not prove a reasonable prospect of success where a meeting is permitted by the court. It is not conducive to a hostile takeover. If a company is insolvent and attempts to propose a scheme of arrangement without the consent of the administrator or liquidator, such a meeting is unlikely to be approved by the courts.<sup>198</sup>

Nevertheless, the court will allow meetings to be held so that those proposing the scheme are at least afforded the opportunity to convince a majority of the voters as to the merits of the proposal. Pilkington points to the Goldshield Group's takeover by scheme proposal in 2009

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<sup>196</sup> Philip R Wood, *Conflict of Laws and International Finance*, Vol 6 (Sweet and Maxwell 2007) para 20-016.

<sup>197</sup> [1981] Ch 351.

<sup>198</sup> For example, *International Contract Co (Hankey's Case)* (1872) 26 LT 358.

when just over 11% of the company's owners decided to propose the arrangement and for which the court approved an initial meeting for consideration by voters.<sup>199</sup>

The approval of the meeting for consideration of a takeover scheme raises disclosure issues of the interests of the directors, the impact that approval of the scheme would have on those interests and all the information the court directs to aid decision-making.<sup>200</sup> White J asserted in *Residues Treatment v Southern Resources* that disclosure must be guided by the principles of fairness and reasonableness regarding the best interests of the company in its entirety, irrespective of the circumstances.<sup>201</sup> This in any case is demanded by section 172 of the CA 2006.

It was noted that too much information, particularly of a technical nature, is distracting and scarcity may result in misrepresentation, particularly due to deliberate omission and the court will intervene, in its supervisory capacity, to fix faults and cure complaints.<sup>202</sup> The court must "approach the matter strictly and can only tolerate nondisclosure in a case where it is satisfied that it is essentially of a de minimis nature".<sup>203</sup> It is worthy of note that uncorrected mistakes will result in the court ordering the reproduction of the statement and reconvening the meeting to consider the scheme, unless the court can be convinced that the failure to include some information is unlikely to have influenced the member vote.<sup>204</sup>

Legal members of the company, rather than those with simply a beneficial interest under a trust, will have the right to vote on a scheme of arrangement, whether as a total of the corporate body or by class, where there is an effect upon their entitlements. Legal members are the persons or entities who actually hold the shares in their names and are listed in the membership documents of the company, even though they may not have actual control over

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<sup>199</sup> Pilkington (n 10) Ch 3.

<sup>200</sup> *Residues Treatment & Trading Co Ltd v Southern Resources Ltd* (1988) 14 ACLR 375.

<sup>201</sup> *ibid.*

<sup>202</sup> *ibid* 378.

<sup>203</sup> *Jessel Trust Ltd* [1985] BCLC 119, para 127 (Slade J).

<sup>204</sup> *Imperial Chemical Industries Ltd* [1936] 2 587 (Ch), para 618.

the corporate operation.<sup>205</sup> Those entitled to vote according to the company's specification, if they reach a consensus of approval can expect the scheme to be approved by the court at the subsequent meeting, a procedural rather than evaluative decision subject to proof of regulatory requirements being satisfied. In a takeover process, ownership is transferred.

Nevertheless, the UK courts have shown that they will not automatically stamp approval simply on the basis that the scheme is rationally supported and is procedurally compliant. In *Prudential Assurance Company Ltd*<sup>206</sup>, the company sought to sell its annuity provision service to Rothsay, a stable company which on the face of the arrangement was capable of providing a similar service to annuity recipients. Pensioner-annuity recipients tend to look beyond mere capacity and choose their provider based on longevity of relationships and reputation, which Rothsay, a 'relatively new entrant to the market' did not have and so the discretionary power to approve a section 111(3) of the Financial Services and Markets Act 2000 transfer under a scheme was declined.<sup>207</sup> The interests of the most important stakeholders faced an unmeasurable but important risk element they had not anticipated when they spent their pension pot.

### **2.5. Schemes of Arrangement in the Context of Financial Distress**

Omar and Gant consider that the introduction of Schedule B1 to facilitate the operation of the IA 1986 administration procedure has aided the implementation of an associated scheme of arrangement as part of a strategic plan to deal with the impending risk of insolvency.<sup>208</sup> Each process has an impact on the level of interest and involvement of members depending on the future prospects of the company as assessed by the administrator. The first aim is (i) to manage assets and liabilities to rescue the company as a going concern, but if this is not possible, or useful, (ii) to achieve a better financial return for the company members and stakeholders than would be available on liquidation, and if all else fails, (iii) the bankruptcy fire-sale and

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<sup>205</sup> Thomas B Courtney and Una Curtis, *Bloomsbury Professional's Company Law Guide 2017* (Bloomsbury 2017) 199.

<sup>206</sup> [2019] EWHC 2245 (Ch).

<sup>207</sup> *ibid*

<sup>208</sup> Paul J Omar and Jennifer Gant, 'Corporate Rescue in the United Kingdom: Past, Present and Future Reforms' (2016) 24(1) *Insolvency Law Journal* 40.

distribution to preferential creditors with generally total loss experienced by the broader unsecured creditor body.<sup>209</sup> Mallon and Waisman take a somewhat contrary view which is that “English law has remained ... generally unrepentantly pro-creditor”, and has not fully embraced the ‘rescue culture’ of the US Chapter 11 Protection from Creditors perspective.<sup>210</sup> Nevertheless, schemes of arrangement to reorganise and restructure company debt, especially in the context of impending liquidation, broadly fit the categories of (i) the ‘pre-pack’ or ‘transfer’ of the business undertaking, rather than rescuing the company *per se*, generally used by larger, senior creditors to enforce their rights and interests over others<sup>211</sup> and (ii) a ‘cram-down’ scheme, when the management seek support from more amenable stakeholders with sufficient value to counteract resistance from the major creditor.<sup>212</sup>

The ‘pre-pack’ method typically involves a company or administrator selling its assets to a new company before declaration of bankruptcy to realise a greater value for members and creditors to discharge its debts and perhaps restructure its interests.<sup>213</sup> This is not a company rescue process, but is undertaken to save the business under the auspices of a new owner. The effect of this administration based procedure is expected to preserve the operation and interests of stakeholders and employees under new management, just not in the same company.<sup>214</sup> It need not be approved by the court, nor indeed have the support of even the most major of creditors, *per DKLL Solicitors*.<sup>215</sup> It carries the risk of overriding minority interests in the pursuit of maximising the benefit to majority stakeholders. In *Bluebrook*, for example, senior creditors transferred the assets of the old company to a new one without requiring any input from junior

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<sup>209</sup> *ibid.*

<sup>210</sup> Christopher Mallon and Shai Waisman, *The Law and Practice of Restructuring in the UK and US* (Oxford University Press 2011) 5.

<sup>211</sup> John Armour, ‘The Rise of the “Pre-Pack”’: Corporate Restructuring in the UK and Proposals for Reform’ in R Austin and G Fady (eds), *Restructuring Companies in Troubled Times: Direct and Creditor Perspectives* (Ross Parsons Centre of Commercial, Corporate and Taxation Law 2012) 49-55.

<sup>212</sup> Jennifer Payne, ‘UK Debt Restructuring Mechanisms: New Developments in Practice and Law Reform’ in Sarra JP and Romaine JB (eds), *Annual Review of Insolvency Law* (Carswell 2016) 42.

<sup>213</sup> Teresa Graham CBE, *Graham review into Pre-pack Administration* (The Insolvency Service, 16 June 2014) <<https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration>> accessed 20 September 2019.

<sup>214</sup> *ibid* 26.

<sup>215</sup> Payne (n 212).

creditors claiming their rights to be unaffected by this arrangement, and given that the courts will generally not interfere with requisite majority business decisions, it was approved.<sup>216</sup>

The interests of creditors may not be aligned with each other, usually a lack of support for a scheme of arrangement favoured by senior stakeholders-creditors from more minor creditors; this is often overcome by the greater voting power by value. Given that a scheme of arrangement requires approval by a 75% by value majority of creditors, funding the scheme whether by the provision of additional finance or surrender of full entitlement to facilitate continuance of the company will generally fall to the larger majority creditors. Gudgeon and Joshi assert that the UK is perceived as a creditor-friendly jurisdiction that offers an experienced judiciary which takes a commercial approach to corporate needs, allowing for a cram-down on dissenting creditors seeking advantage in obstruction.<sup>217</sup> The 75% by value majority voting requirement effectively seeks to exclude minority creditors or members with an interest in frustrating the continuation of the company.

However major creditors too may be the dissenting parties, giving rise to a need to garner sufficient support from minority interests. This will necessarily lead to consideration of negotiating a cram-down scheme via an alternative source of funding rearrangement for the survival and restructuring of the company. Wood defines cram-down as “the over-riding of votes of a dissentient class of claimants who voted against the plan”.<sup>218</sup> It effectively disenfranchises a significant voting class which is likely to lose all entitlement, which will in any case occur if the company fails.<sup>219</sup> It is therefore less controversial where the company has a prospect of survival or has the means to discharge the costs associated with a scheme of arrangement over a period of time. The funding for the arrangement is provided by the company itself.

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<sup>216</sup> *Bluebrook Ltd* [2009] EWHC 2114 (Ch).

<sup>217</sup> Martin Gudgeon and Shirish Joshi, ‘The Restructuring and Workout Environment in Europe’ in Graham Lane, *Restructuring and Workouts: Strategies for Maximising Value* (3rd edn, Globe Law and Business 2019).

<sup>218</sup> Philip Wood, *Principles of International Insolvency* (2<sup>nd</sup> Edition, Sweet and Maxwell 2007) 22-035.

<sup>219</sup> *ibid.*

The EU Directive on restructuring, insolvency and discharge procedures 2012/30/EU, as amended on its approval in March 2019, emphasises that cross-class cram-downs should not unfairly prejudice dissenters under the proposed plan.<sup>220</sup> The UK government has not yet adopted the Restructuring Directive into domestic law which aimed at harmonising the laws of rescue and insolvency within the single market.<sup>221</sup> Member states have until July 2021 to implement the EU Directive, and as the UK will no longer be a EU member state by then, it will not be obliged to implement it. The Directive includes the absolute priority rule relating to creditor cram-down procedures, effectively binding dissenters to the agreement reached with the majority classes but requiring that they be paid in full before distribution to lower ranking creditors.<sup>222</sup> This will not necessarily prevent attempts to frustrate a scheme plan, but the court retains a power of derogation where restructuring is a viable route to business and company rescue and where it is fair and reasonable.<sup>223</sup>

The 2008 financial crisis was a landmark event giving rise to years of market turmoil and corporate risk, accompanied by considerable dissent on the prospects of companies being able to continue to trade out of trouble and the ‘cutting of losses’ as businesses showed signs of failure. Majority creditors may seek a scheme of arrangement for their debtor companies to preserve their financial entitlements, their minority co-creditors seeking a more immediate return of at least some of their investment to secure their own survival. In this particular context of global meltdown it would seem that the courts had been willing to allow cram-down proposed schemes to work within a class of voters but not across different classes.<sup>224</sup>

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<sup>220</sup> European Parliament legislative resolution of 28 March 2019 on the proposal for a directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU (COM(2016)0723 – C8-0475/2016 – 2016/0359(COD)) para 55.

<sup>221</sup> Anne Mennens, ‘Puzzling Priorities: Harmonisation of European Preventive Restructuring Frameworks’ (Oxford Business Law Blog 29 March 2019) <<https://www.law.ox.ac.uk/business-law-blog/blog/2019/03/puzzling-priorities-harmonisation-european-preventive-restructuring>> accessed 20 September 2019.

<sup>222</sup> See Section 5 of the BEIS (n 159).

<sup>223</sup> Jennifer Payne, ‘The Government Announces Radical Changes to the UK Debt Restructuring Regime’ (Oxford Business Law Blog 11 September 2018) <<https://www.law.ox.ac.uk/business-law-blog/blog/2018/09/government-announces-radical-changes-uk-debt-restructuring-regime>> accessed 20 September 2019.

<sup>224</sup> Payne (n 212).

Another solution to financial distress is, effectively, a ‘creditor takeover’. In 2017, Bibby Line Group Limited (BLG), facing demise and liquidation, entered into negotiations with creditor noteholders on debt reorganisation.<sup>225</sup> This resulted in the transfer of its assets, in the form of a ‘debt-for-equity restructuring’ to Bibby Offshore’s bondholders.<sup>226</sup> Punnett was rather more blunt about the scheme, viewing it as a relatively hostile takeover by the bondholders rather than ordinary refinancing.<sup>227</sup> Although BLG sought further investment from its shareholders, a major creditor bondholder took control of the process of refinancing and used its debt leverage to resist refinancing proposals and pursue the alternative of a takeover of the shipping business. As commented upon by the solicitors involved, “the combination of careful stakeholder management, finding and tailoring the right restructuring solution, and effective restructuring tools, allowed Bibby Offshore to re-enter safe waters, ensuring that it has a strong consolidated position from which to expand in the markets in which it operates”.<sup>228</sup> Flexibility to change plans, adapt to the market demands and adopt alternative proposals for direction and solution can achieve the preservation of a potentially successful business.

The solutions offered by schemes of arrangement to companies facing financial distress have been the focus of this section, from seeking to effect survival, maximisation of the value of assets where this is not possible, and managing dissolution. It has also been noted that provisions have been made to prevent minority dissenters from inhibiting the rescue process and to facilitate the primacy of the interests of the company’s success being pursued by directors in accordance with their governance duties. Paterson and Pink note “it drags along hold-outs or disengaged parties”.<sup>229</sup>

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<sup>225</sup> *Bibby Offshore Services Plc* [2017] EWHC 3402 (Ch).

<sup>226</sup> Latham and Watkins LLP, ‘UK Restructuring Scheme Case Study: Guiding Bibby Offshore into Safe Waters’ (Latham & Watkins LLP 12 February 2018) <<https://www.latham.london/2018/02/uk-restructuring-scheme-case-study-guiding-bibby-offshore-into-safe-waters/>> accessed 20 September 2019.

<sup>227</sup> Jeremy Punnett, ‘Bibby Offshore restructuring ... End of an era ...’ (From the South Sea 28 November 2017) <<https://fromthesouthsea.com/2017/11/28/bibby-offshore-restructuring-end-of-an-era/>> accessed 20 September 2019.

<sup>228</sup> Latham and Watkins LLP (n 226).

<sup>229</sup> Sarah Paterson and Michael Pink, ‘Wrangling Reform into the Insolvency Toolbox’ (Recovery Legal Update Summer 2019) (n 160) 14.



It does, however, undermine the enforcement of the rights of a quarter by value of creditors, potentially completely depriving them of debt repayment, but this is ameliorated by the principles of fairness monitored by the court. Nevertheless, the court will not interfere with business-based decisions, even when there is an arguably better suited alternative. This issue arose in *Realm Therapeutics*<sup>230</sup> which is a medical provisions, services and investment company that faced liquidation due to the failure of product development of manufacturers in which it had invested. The board choice of a takeover partner was resisted by minority creditors whose interests, and indeed those of the company and broad creditor base, they argued, would be better served by another company. The statutory majority placed their trust in the board, and the alternative company argued 'minority oppression' and majority *mala fides*. While their arguments carried some commercial weight, the court determined this was not a basis for refusing approval given statutory compliance with the scheme process. The scheme evidently placed considerable authority in the hands of the directors, unmatched by the insolvency procedures, without significant risk of sanction for their decisions, provided that they could convince the majority to follow.

Scheme planning is part of a broad range of restructuring mechanisms available to companies and its increasing prevalence as a means of resolving financial difficulties may be attributable in part to the inadequacies of other insolvency mechanisms. The Insolvency Service in 2016 found that the current insolvency framework in the UK does not adequately provide for restructuring plans.<sup>231</sup> The UK government is currently conducting a review of corporate insolvency mechanisms and this may lead to reforms that will affect the role and nature of schemes of arrangement in the future.

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<sup>230</sup> *Realm Therapeutics* [2019] EWHC 2080 (Ch).

<sup>231</sup> The Insolvency Service, *A Review of the Corporate Insolvency Framework: A Consultation on Options for Reform* (25 May 2016). See also, The Insolvency Service, *Summary of Responses: A Review of the Corporate Insolvency Framework* (HMSO 2016) 1.6. The Insolvency Service (n 156) 1.6.

## 2.6. The Impact of Brexit on Existing Types of Schemes of Arrangement

At this stage, much of the effect on UK law and corporate operations in particular are necessarily somewhat speculative given that there is no element of certainty which would strengthen a clear perception of the future. It must be based on a tentative assessment of the context of political and economic change in comparison the current state of affairs. Brexit, should it occur, may have an impact on the application for and recognition of schemes of arrangement. There is a 'new deal' available for consideration by Parliament but nothing to indicate it will be progressed. Significant proposed de-regulation measures will necessarily affect the viability and jurisdictional recognition of the UK and its potential attractiveness to foreign companies, but political speculation on this issue has proved elsewhere to be a waste of time and words. Nevertheless, examples are starting to arise of multinational companies beginning to move bases of operation to other EU jurisdictions to deal with the business uncertainty in the political relationships.

### 2.6.1. Planning for Brexit

Barclays Bank Plc and Barclays Capital Securities Limited have transferred a considerable part of their private client investment based operations to their Ireland subsidiary.<sup>232</sup> The plan was carried out whereby Barclays Bank Ireland will now be the principle supplier of banking services to European clients or those desirous of easy access to the single market.<sup>233</sup> The process did not directly involve the rights of members, nor indeed the entitlements of creditors, simply changes to contracts and obligations insofar as territory and jurisdiction was concerned. Justice Snowden noted: "The design of the scheme has been based upon an assumption that there will be no favourable outcome of the current political negotiations between the U.K. and the EU as regards passporting or the grant of equivalence status to the UK in respect of financial

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<sup>232</sup> Harry Wilson, Stefania Spezzati and Alexander Weber, 'Barclays May Transfer 5,000 Clients to Ireland in \$217 Billion Brexit Move' (Bloomberg Business 30 January 2019) <<https://www.bloomberg.com/news/articles/2019-01-30/barclays-may-transfer-5-000-clients-in-217-billion-irish-move>> accessed 20 September 2019.

<sup>233</sup> Barclays 'Summary of the Scheme' <<https://www.home.barclays/content/dam/barclayspublic/.../Scheme%20Summary.pdf>> accessed 20 September 2019.

services".<sup>234</sup> The scheme of arrangement procedure proved its flexibility in the management of political risk. Euroclear, another securities company providing financial and investment services, followed suit and transferred its operations from the UK to Belgium to preserve unfettered access to the European single market.<sup>235</sup> There was no need to differentiate classes of members for votes given that there was no issue on financial changes which would affect interests and rights.<sup>236</sup> The High Court commented on the wisdom of the scheme and the clear communication of its purpose to members, which made overwhelming shareholder and creditor support inevitable.<sup>237</sup>

It is not only financial services multinationals that seek continuity of access to the European market and the facilities it offers in the world trade environment. Steris Plc is a provider of healthcare products and services with a broad customer base across Europe, the Middle East, the Americas, Asia and Africa.<sup>238</sup> An American company based in England, it planned to move its centre of operations to Ireland. This was described by the High Court as a 'redomicile' and effectively created a new parent company for its worldwide operations.<sup>239</sup> The scheme of arrangement to give formal effect to the change was a relatively simple and uncontentious affair, cancelling the whole of the ordinary share issue for the English company and reissuing the same as an Irish entity. No loss was to be incurred by the shareholders, and indeed those with preference shares were unaffected, nor were creditor interests affected, and the future trading ability of the company was assured. The court's only concern was the capital reduction which necessarily occurred on the cancellation of the shares before the issue of new ones. This was recognised as merely a technical issue which should not interfere with a wise plan.<sup>240</sup>

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<sup>234</sup> Wilson (n 232).

<sup>235</sup> *In the Matter of Euroclear Plc* [2018] 11 WLUK 273.

<sup>236</sup> Tom Henderson and Natasha Johnson, 'Brexit Commercial Driver Behind Scheme of Arrangement' (Herbert Smith Freehills 23 November 2018) <<https://hsfnotes.com/brexit/2018/11/23/brexit-commercial-driver-behind-scheme-of-arrangement/>> accessed 20 September 2019.

<sup>237</sup> *ibid.*

<sup>238</sup> Steris Corporation <<https://www.steris.com/about/company/>> accessed 20 September 2019.

<sup>239</sup> *Steris Plc* [2019] EWHC 751 (Ch).

<sup>240</sup> *ibid.*

The Brexit influenced changes are related to broader regulatory uncertainty and change, and indeed in industries subject to a high degree of governmental supervision there are financial advantages to jurisdictional change. This is not specifically highlighted in the *Man Group Plc* advisory application to the High Court but as an investment company its directors considered it prudent to domicile its operations in the Channel Islands.<sup>241</sup> It proposed cancelling and reissuing shareholdings to facilitate the move from its UK base, the intention being to dissolve the UK company and resurrect the business in Jersey. It was essentially a share swap to a new company with the same management. Although not *prima facie* related to the Brexit uncertainty of the UK's continued membership, it appears to anticipate a more rigid regime of regulatory governance.

### 2.6.2. *The Brexit Effect*

Although the international law firm Freshfields Bruckhaus Deringer warned that the UK can no longer expect automatic recognition of bankruptcy proceedings, there is little to suggest the UK's exit will affect the enforceability of schemes of arrangement where they effect restructure.<sup>242</sup> The adoption of an ever-more pragmatic and commercial approach by the English courts to schemes of arrangement with international dimensions will prove helpful in this respect as will the already entrenched acceptance of UK restructures.<sup>243</sup>

It is noted, however, that differences have arisen in the law of insolvency in the UK and its relationship to EU practices, largely because the UK schemes of arrangement form part of company rather than insolvency law, and thus are not treated by the EU as an insolvency

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<sup>241</sup> *Man Group Plc* [2019] EWHC 1392 (Ch).

<sup>242</sup> Freshfields Bruckhaus Deringer, 'Brexit: What Does it Mean for Restructuring and Insolvency?' (Oxford Business Law Blog 13 July 2016) <<https://www.law.ox.ac.uk/business-law-blog/blog/2016/07/brexit-what-does-it-mean-restructuring-and-insolvency>> accessed 20 September 2019.

<sup>243</sup> Thomas Sharpe, 'Commercial Law Post Brexit Next Steps for the UK' (Politeia 2018) 2 <<http://www.politeia.co.uk/wp-content/Politeia%20Documents/Unpublished/Thomas%20Sharpe%20QC,%20'Commercial%20Law%20Post%20Brexit'.pdf>> accessed 20 September 2019.

process.<sup>244</sup> This makes the position of the UK context of bankruptcy law more difficult to resolve, although the recently implemented Directive 2017/1132/EU has been incorporated into national law.<sup>245</sup> Buckley points out that the English courts will necessarily consider the EU Judgments Regulations as a pre-acceptance jurisdiction issue.<sup>246</sup> They should also show an acute awareness of international recognition of scheme arrangements before proceeding.<sup>247</sup>

The changes relating to the restructuring of companies under Directive 2017/1132/EU will make it easier for potentially insolvent companies to begin restructuring their operations earlier.<sup>248</sup> The European Parliament requires legislation to be introduced by Member States for changes to insolvency law and practice within the single market to essentially allow for the rehabilitation of failed entrepreneurs who still have a great deal to offer the market.<sup>249</sup> Effective restructuring and insolvency frameworks directly affect creditors' recovery rates, from 30% in Croatia and Romania to 90% in Belgium and Finland.<sup>250</sup> The credibility of the amended processes is based on enhancement of transparency and protections, proper training and supervision of those involved, and the availability of a 'second chance' for competent business entrepreneurs.<sup>251</sup> The UK has already introduced secondary legislation to accommodate the harmonisation process but will need to further adapt its domestic legislation to compete with the European nations and fit into the Union framework, particularly in the realm of worker rights. This is a source of political controversy in the UK domestic process.<sup>252</sup>

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<sup>244</sup> Katrina Buckley, 'The Rise and Rise of the English Scheme of Arrangement' (Allen and Overy 21 December 2015) <<http://www.allenoverly.com/publications/en-gb/Pages/The-rise-and-rise-of-the-English-scheme-of-arrangement.aspx>> accessed 20 September 2019.

<sup>245</sup> Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law [2017] OJ L169/46, art 86.

<sup>246</sup> Buckley (n 244).

<sup>247</sup> For example, see *In Avanti Communications Group* (n 107).

<sup>248</sup> Nicolaes Tollenaar, 'The European Commission's Proposal for a Directive on Preventative Restructuring Proceedings' (2017) 30(5) *Insolvency Intelligence* 65.

<sup>249</sup> Directive (EU) 2017/1132 (n 245).

<sup>250</sup> *ibid.*

<sup>251</sup> European Parliament legislative resolution of 28 March 2019 (n 220) para 40.

<sup>252</sup> Margaret Proctor, 'The Potential Impact of Brexit on Employment Rights and Fairness at Work' (University of Plymouth) <<https://www.plymouth.ac.uk/news/pr-opinion/opinion-the-potential-impact-of-brexit-on-employment-rights-and-fairness-at-work>> accessed 20 September 2019.

Currently, the EU Judgments Regulation and EU Rome I Regulation require that other EU Member States recognise judgments from the UK and of each other. That can no longer be automatically presumed in the absence of an agreement to that effect after the UK separates from the Union.<sup>253</sup> This will potentially impede the ability of creditor schemes of arrangement to gain control over company assets if these are located in an EU Member State. That is another, probably hitherto forgotten, provision to add to the list. Control over its own law will of course provide the opportunity of avoiding the restrictive protections for, as an example, minority shareholders and creditors who hinder the will and needs of business through judicial supervision for schemes and takeover code regulations.

## **2.7. Conclusion**

In the UK, schemes of arrangement have, since their introduction into legislation in 1862, sought to facilitate change in corporate organisations which aids adaption to internal and market imperatives, from managing insolvency to expanding across the globe. Their purposes have burgeoned, originally designed to address companies in financial distress by restructuring debts and affording time to undertake extensive internal restructuring with the prospect of survival or achieving an orderly demise. The schemes no longer operate within such strict confines and, with relatively minor legislative change and broad judicial interpretation have become a highly flexible, popular and attractive mechanism for corporate takeovers and mergers, be they domestic processes or embracing the international market.

The next chapter will consider how schemes of arrangement are used in other jurisdictions, particularly former British colonies and current members of the Commonwealth. In addition, Ireland and Germany are also examined. It will examine the extent to which the national politico-economic culture of these jurisdictions has helped to shape their schemes of arrangement and their use in the contemporary business environment. This will provide insight

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<sup>253</sup> Jennifer Marshall, Joel Ferguson and Lucy Aconley, 'Brexit: What Next for Cross-border Restructurings and Insolvencies?' (LexisNexis August 2016) 150 <[https://blogs.lexisnexis.co.uk/randi/wp-content/uploads/sites/8/2016/09/Brexit\\_what\\_next\\_for\\_cross-border\\_restructu.pdf](https://blogs.lexisnexis.co.uk/randi/wp-content/uploads/sites/8/2016/09/Brexit_what_next_for_cross-border_restructu.pdf)> accessed 20 September 2019.

into the difficulties of transplanting such mechanisms from one jurisdiction to another and the challenges that would arise by attempting to create a global scheme of arrangement regime. This will bear on discussion of the aims of the new Saudi law.

### **3. Chapter III: The International Development of Schemes of Arrangement: An Overview of Selected Jurisdictions**

#### **3.1. Introduction**

The UK legislative framework, arguably, promotes flexibility in corporate restructurings. This began in the mid-1800s, which was a time of rapid expansion of the Industrial Revolution, and eventually formalised into the multi-purpose scheme of arrangement of the late 20<sup>th</sup> century. In this chapter, the purpose is to conduct a comparative review and analysis of international jurisdictions with diverse socio-economic political frameworks operating civil and common law administrations. The legal systems explored, and their use of schemes to facilitate the reorganisation of domestic and international corporations, reflect the advanced developed nature of European states, Germany and Ireland, the southern hemisphere, Australia and New Zealand, Singapore in the Far East, Canada and the economically developing South Africa. Chapter 11 proceedings in the US will also be considered in the context of bankruptcy. Each has a historical, political and economic relationship to the UK with relatively advanced national economies which make similar demands on the legal systems which govern corporate operations.

Broad legislative principles of prudence and responsibility lie across all jurisdictions. Commercial practice has led to the adoption of a choice of strategies to deal with companies facing financial difficulties of varying degrees, ranging from complete insolvency to attempt at revival of a failed business entity, and indeed with corporate mergers and management restructure. They help restrain management incompetency, mistakes and failures of the corporate executives and leaders in terms of misplaced investment and ill-researched strategies. Stelnik gives a broad definition of risk as “a measurable event affecting the company and occurring because of changing both internal and external environment of the company”.<sup>1</sup> It is clearly better than ‘rectification’, and indeed risk may be exacerbated by over-enthusiastic

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<sup>1</sup> Mikhail Stelnik, ‘Corporate Restructuring as a Risk Treatment Method’ (2016) 17(3) *Business: Theory and Practice* 225.



creditors guided by investment fashion who fail to perform due diligence before lending. Duties of care and pursuit of the interests of the company demanded of directors and management are universal in corporate governance, not only to ensure financial prudence, endorsed by the G20 International forum of governments and central bank governors and the OECD.<sup>2</sup> Strategy, too, in the choice of methods of evolutionary reconstruction of the corporate entity lie with directors, acting in the best interests of the company, which may differ from those of its diverse stakeholders.

It is a broad examination of legal frameworks to fulfil the purpose of the research focus, the analysis of the construction and operation of schemes of arrangement in diverse legal systems to examine how such schemes are formulated and made to work in different socio-economic and political contexts. This will give an insight into the potential of adaptive transplantation of the legal principles of corporate restructure into different jurisdictions. It will be noted, for example, that a common feature of schemes, regardless of jurisdiction, is the majority voting procedure to approve structural change, the 'headcount test', otherwise known as 'one member one vote' regardless of the size of shareholding. A prominent feature of UK statutory regulation process, it allows 75% by value of creditors, to override minority dissent to fundamental reorganisation which has the potential to adversely, and significantly, affect their interests.<sup>3</sup> It also facilitates the opportunity of relatively small creditors to obstruct measures planned to ensure the future economic well-being of the company.<sup>4</sup> This, it would be thought, would undermine the popular perception of such a flexible and adaptable method of corporate evolution in a fluid market, but this appears not to be the case. The headcount test has been adapted to limit tactical abuse in some jurisdictions. It is, however, becoming commonly considered an anachronistic feature which inhibits corporate stability and economic

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<sup>2</sup> OECD, G20/OECD Principles of Corporate Governance (OECD 2015) <<https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf>> accessed 20 September 2019.

<sup>3</sup> Amy Lo, 'Better Late than Never ... Hong Kong Government's Proposal to Abolish the Headcount Test' (Clifford Chance 31 May 2012) <[https://www.cliffordchance.com/briefings/2012/05/better\\_late\\_thanneverhongkonggovernment.html](https://www.cliffordchance.com/briefings/2012/05/better_late_thanneverhongkonggovernment.html)> accessed 20 September 2019.

<sup>4</sup> *Dee Valley Group Plc* [2017] EWHC 184 (Ch).

development through tactical means adopted by active, self-interested shareholders<sup>5</sup> Nevertheless, the value of schemes of arrangement in the pursuit of economic success are fundamental, regardless of the location of the company.

The US may appear to be a glaring omission from this evaluative process, and, indeed, comment has been made in Chapter I of the legislative manner by which it deals with corporate financial distress via Chapter 11 protection to facilitate debt restructure.<sup>6</sup> The company thereby becomes a 'debtor in possession' and has 120 days to file a plan to "either restructure the operating business, or sell business assets under better circumstances than a Chapter 7 liquidation".<sup>7</sup> There has, however, been a significant decline of a third in such applications in the last three years as companies and creditors have found it more efficient to settle problems in out of court restructures.<sup>8</sup> The corporate protective nature of the Chapter 11 process is arguably reflected in European schemes as integral to the rescue imperative of legislation.<sup>9</sup> It allows the business to function while staving off legal action from creditors who, when they become aware of financial difficulties, tend to activate *en masse*.

Although formal schemes of arrangement do not form part of its corporate restructuring legal landscape, this process of company reorganisation, adopted in and effected by other jurisdictions, is accepted as legally binding within the US jurisdiction.<sup>10</sup> This particular perspective on the recognition of the changing nature of business organisations, their ownership and enforcement of liabilities and obligations is integral to the operation of the global trade market.

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<sup>5</sup> Andrew Rich and Robert Moore, 'Court Stops Share Splitting From De-Railing a Scheme of Arrangement' (Herbert Smith Freehills, 27 February 2017).

<sup>6</sup> Chapter I, 1.5.5 and seq.

<sup>7</sup> Davidson Backman Medeiros Plc, 'What is Chapter 11 Bankruptcy?' (Davidson Backman Medeiros 2017) <<https://dbm-law.net/what-is-chapter-11-bankruptcy/>> accessed 20 September 2019.

<sup>8</sup> CorporateLiveWire, 'Bankruptcy & Restructuring 2018: Virtual Round Table' (Reinhart Law 2018) 7 <[https://www.reinhartlaw.com/wp-content/uploads/2018/12/Blain\\_Virtual-Round-Table\\_Bankruptcy-Restructuring\\_12-18.pdf](https://www.reinhartlaw.com/wp-content/uploads/2018/12/Blain_Virtual-Round-Table_Bankruptcy-Restructuring_12-18.pdf)> accessed 20 September 2019.

<sup>9</sup> Paul McGhee, 'A 'Chapter 11' Law for Europe's Entrepreneurs' (Euractiv 26 February 2016) <<https://www.euractiv.com/section/euro-finance/opinion/a-chapter-11-law-for-europes-entrepreneurs/>> accessed 20 September 2019.

<sup>10</sup> For example, see *Avanti Communications Group* [2018] 582 BR 603 (United States Bankruptcy Court, SD New York, 2018).

The new structure of a corporation may be accepted by the law of the jurisdiction in which the rearrangement occurred, but this is of little value to entities which operate internationally where its new format is not recognised by the law of other states. In the context of reorganisation during financial distress, Kortmann and Michael Veder aver that schemes of arrangement need to extend to states in which the debtor company holds assets if they are to be seen as effective and producing the desired effect.<sup>11</sup> This must be the case even where there is no comparable legal process. This approach to the recognition of schemes of arrangement by the US is consistent with other jurisdictions, which simply require that the corporate restructure by scheme has been appropriately approved in line with the law of the jurisdiction in which it was effected.<sup>12</sup>

The aim of this chapter's discussion is therefore to contrast differing approaches to schemes of arrangement as a more efficient and flexible means of restructuring companies than other restructuring mechanisms. Indeed, given the fact of global market and legal recognition of the new, restructured entity, jurisdictions such as Singapore have marketed themselves as an attractive destination for corporate adaptation to evolving demands through the limitation of regulatory requirements for compliance. This will enable more considered analysis of the proposed new schemes of arrangement for corporate rescue and restructure within the political, Islamic-based business culture in the KSA to be discussed in the subsequent chapter. Reference will be made to the basis of the framework of law in each of the nations examined in this chapter. The broad, though not exclusive, systems are either (i) the common law, predicated on the historical practices of enforcing custom and statute by reference to judicial precedent, the base of UK and Commonwealth legal frameworks<sup>13</sup> and (ii) the civil jurisdiction, a statutory code of ordered legal principles as a legislative based primary source of law.<sup>14</sup>

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<sup>11</sup> Lucas Kortmann and Michael Veder, 'The Uneasy Case for Schemes of Arrangement under English Law in Relation to non-UK Companies in Financial Distress: Pushing the Envelope?' (2015) 13 Nottingham Insolvency and Business Law e-Journal 239, 240.

<sup>12</sup> *Far East Capital Ltd SA* [2017] EWHC 2878.

<sup>13</sup> Steve Shepherd, 'Western Philosophies of Law: The Common Law' in Aaron Schwabach and Arthur Cockfield (eds), *Law – Volume I* (EOLSS 2009) 73.

<sup>14</sup> Roger LeRoy Miller and Frank B Cross, *The Legal Environment Today* (Cengage Learning 2015) 16.

### 3.2. Australia

Schemes of arrangement in Australia deviate little from the British model,<sup>15</sup> and are regulated by section 411 of the Australian Corporations Act 2001 (ACA 2001):

“Where a compromise or arrangement is proposed between a company and its creditors or any class of them or between a company and its members or any class of them, the Court may, on the application in a summary way of the company or of any creditor or member of the company, or, in the case of a company being wound up, of the liquidator, order a meeting or meetings of the creditors or class of creditors or of the members ... or class of members to be convened in such manner, and to be held in such place or places ... as the Court directs.”<sup>16</sup>

Australian corporate law on company restructure has evidently embraced the three-step process for such schemes; (i) the proposal for change is submitted by the applicant company to the court, which then (ii) orders stakeholder meetings to be held to provide relevant members and creditors with a forum to discuss, accept, amend or reject the scheme<sup>17</sup>, before a further court hearing to sanction the rearrangement.<sup>18</sup> Once the court has sanctioned the scheme, it attains legal stature after being lodged with the Australian Securities and Investment Commission (ASIC).<sup>19</sup> Disclosure requirements are the same.<sup>20</sup>

#### 3.2.1. Foreign Companies and Jurisdiction

Jurisdiction to accept consideration of and to sanction a scheme or deed or arrangement is legislated for in the ACA 2001, and is limited to Part 5.1 companies defined as those (i) incorporated in Australia and (ii) a foreign body corporate registered under the Act. Although the second limb of jurisdiction appears somewhat opaque, a foreign company must be

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<sup>15</sup> Tony Damian and Andrew Rich, *Schemes, Takeovers and Himalayan Peaks: The Use of Schemes of Arrangement to Effect Change of Control Transactions* (Centre of Commercial, Corporate and Taxation Law, University of Sydney 2013) 12.

<sup>16</sup> Corporations Act 2001, Section 411(1).

<sup>17</sup> *ibid* Section 411(4)(a).

<sup>18</sup> *ibid* Section 411(4)(b).

<sup>19</sup> *ibid* Section 411(10).

<sup>20</sup> Corporations and Markets Advisory Committee, ‘Members Schemes of Arrangement’ (Australian Government, Corporations and Markets Advisory Committee, Report, 2009) 13  
<[http://www.camac.gov.au/camac/camac.nsf/byheadline/pdfinal+reports+2009/\\$file/members\\_schemes\\_report\\_dec09.pdf](http://www.camac.gov.au/camac/camac.nsf/byheadline/pdfinal+reports+2009/$file/members_schemes_report_dec09.pdf)> accessed 20 September 2019.

registered in the country in order to do business.<sup>21</sup> Rich and Chandrasegaran note that Australian courts would generally decline to accept oversight of a scheme of arrangement in the absence of incorporation where there was no strong commercial nexus with the jurisdiction. Emmett and Whitby indeed noted in 2018 that they knew of no foreign corporation that had initiated a scheme of arrangement in the country.<sup>22</sup> Perhaps they missed the matter of *Redcliffe*, a Papua New Guinean company with 90% of its shareholding dealt on the Australian ASX exchange which sought a share swap with Northern Manganese Ltd.<sup>23</sup> The court appears to have expanded the jurisdiction of scheme oversight and approval under Part 5.1 of the Act based on the shareowner residence link.<sup>24</sup> However, it cannot yet be described as a 'go-to' nation for corporate restructure services.

### 3.2.2. *Creditor Schemes of Arrangement*

There are, however, significant differences in practice between the UK and Australian scheme processes. Creditor schemes of arrangement in the UK existed before member schemes were legislated for, simply because they proved valuable in resolving the liability affairs of companies in financial trouble and undergoing liquidation.<sup>25</sup> Their comparative value to interested member-shareholder and creditors in the UK and Australian jurisdictions however cannot be explained in terms of time and availability of the scheme process. The New South Wales Act 1899 essentially transposed into Australian law the UK's Joint Stock Companies Act 1870, dealing specifically with the availability of schemes to the creditors of distressed companies.<sup>26</sup>

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<sup>21</sup> Andrew Rich and Malika Chandrasegaran, 'Using Australian Schemes of Arrangement to Acquire Foreign Companies' (Herbert Smith Freehills 20 May 2016) <<https://www.herbertsmithfreehills.com/latest-thinking/using-australian-schemes-of-arrangement-to-acquire-foreign-companies>> accessed 20 September 2019.

<sup>22</sup> Dominic Emmett and Alexandra Whitby, 'Corporate Recovery and Insolvency in Australia 2018' (International Comparative Legal Guides 25 April 2018) 7.1 <<https://iclg.com/practice-areas/corporate-recovery-and-insolvency-laws-and-regulations/australia>> accessed 20 September 2019.

<sup>23</sup> *Redcliffe Resources Limited* [2016] FCA 404 and see Australian Stock Exchange, 'Scheme Implementation Agreement' <<https://www.asx.com.au/asxpdf/20150818/pdf/430llvnnwvtp7y.pdf>> accessed 20 September 2019.

<sup>24</sup> Rich and Chandrasegaran (n 21).

<sup>25</sup> Payne (n 8) 7.

<sup>26</sup> *ibid* 8.

Member schemes of arrangement were not introduced in Australia until 1936 with the enactment of section 133 of the Australian Corporations Act.<sup>27</sup> Damian and Rich note that creditor schemes of arrangement remained popular in Australia to deal with debt-laden companies until the introduction in 1993, under the Corporate Law Reform Act 1992, of the simpler 'deed of company arrangement' which represented a more efficient means of restructuring such corporations than the scheme in the event of voluntary insolvency.<sup>28</sup> It is similar to the appointment of an administrator procedure in the UK, whose aim it is to review the company's financial situation and then recommend a course of action for the business to a meeting of creditors.<sup>29</sup> This is a company or secured creditor initiated process. In the context of the UK, should ordinary creditors wish to take action to enforce their debt, this must be done under Schedule B1, Paragraph 10 of the Insolvency Act 1986 for an administration order, which is unlikely to be granted while the scheme of arrangement procedure is making progress. Member schemes of arrangement may currently remain a popular option in company practices where reorganisation is demanded to adapt to changing market circumstances, but creditors facing loss in the context of corporate distress are seeking the relatively new, faster acting option.<sup>30</sup>

### 3.2.3. Alternative Australian Law Restructure Process - Deed of Company Arrangement

The 1993 deed of company arrangement, as drafted, was considered *prima facie* rather lacking in legal procedural substance. The Federal Court in *Lehman Brothers Asia Holdings Ltd (in Liquidation) v City of Swan; Lehman Brothers Holdings Inc v City of Swan*, for example, determined that its pursuit and effect had to be based on a solid foundation of procedural arrangements including, but not limited to, close court supervision.<sup>31</sup> Such a requirement was

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<sup>27</sup> *Theatre Freeholds Ltd* (1996) 20 ACSR 729.

<sup>28</sup> Damian and Rich (n 15) 521.

<sup>29</sup> Andrew Sellars, 'Corporate Voluntary Administration in Australia' (Forum for Asian Insolvency Reform Insolvency Reform in Asia: An Assessment of the Recent Developments and the Role of Judiciary 7-8 February 2001) 3 <<https://www.oecd.org/corporate/ca/corporategovernanceprinciples/1873984.pdf>> accessed 20 September 2019.

<sup>30</sup> Scott Taylor, 'Restructuring and Insolvency in Australia: Overview' (Practical Law 1 July 2016)

<[https://uk.practicallaw.thomsonreuters.com/2-502-1459?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/2-502-1459?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1)> accessed 20 September 2019.

<sup>31</sup> [2010] HCA 11.

integral to its credibility as a restructuring instrument. It imposed a burden of compliance enforced by fines which, of course, the schemes of arrangement did not. It nevertheless appears attractive to creditors because, where the process is elected by the company, it must enter into a formal, albeit voluntary, administration process,<sup>32</sup> effectively transferring control over the company away from the members. This loss of control is not necessary in the negotiations of a scheme of arrangement. Schemes of arrangement may be settled to the point where all creditors are bound, some perhaps protecting their interests more than others, which is generally not possible under other Australian debt-restructuring mechanisms.

Australia must aim to improve its market position amongst the export nations in a highly competitive region dominated by Japan, China and the Asian Tiger nations amongst others. Chinese domestic industries benefit from high levels of government support at times of financial difficulty.<sup>33</sup> In Japan, the diversity of industrial success includes the highly effective revenue producers of consumer goods and chemical production and software.<sup>34</sup> These corporations have traditionally received government support by restriction on competition. The reliance on private law rather than public intervention therefore requires the Australian legal process to provide a flexible, easy access method of corporate restructure, effective in saving a potentially viable company and recognised by the global market.<sup>35</sup> The binding of creditors is a positive aspect of the Australian debt-restructuring system under the deed, but it requires the corporation to be at risk of insolvency by the appointment of an administrator.<sup>36</sup> A global scheme of arrangement, legally effected and internationally sanctioned, must, it is argued, embrace and involve all concerned in corporate affairs including shareholders and members, not simply focused on creditors. Australia also needs to ensure it can offer similar competitive

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<sup>32</sup> Australian Securities and Investment Commission, 'Creditors - Deed of Company Arrangement' (ASIC) <<https://asic.gov.au/regulatory-resources/insolvency/insolvency-for-creditors/creditors-deed-of-company-arrangement/>> accessed 20 September 2019.

<sup>33</sup> Zhang Yue, 'Chinese Government Boosts Financial Support for Small Businesses' (The State Council of The Peoples Republic of China 27 July 2016) <[http://english.gov.cn/premier/news/2016/07/27/content\\_281475402898158.htm](http://english.gov.cn/premier/news/2016/07/27/content_281475402898158.htm)> 26 September 2018.

<sup>34</sup> Michael E Porter and Mariko Sakakibara, 'Competition in Japan' (2004) 18(1) *Journal of Economic Perspectives* 27, 35-39.

<sup>35</sup> ARTA, 'Policy Positions of the Australian Restructuring Insolvency and Turnaround Association' (February 2015).

<sup>36</sup> ASIC (n 28).

corporate legal methods of reorganisation to its neighbours, which encourage financial institutions to develop patience and provide finance, albeit without publicly funded rescue packages.

Damian and Rich's study of takeovers in Australia for the period 2009 to 2012 found that 65% of friendly takeovers were conducted using schemes of arrangement.<sup>37</sup> Such member schemes in Australia are expressly provided for by section 411(17) of the ACA 2001 which gives the courts discretion to approve this form of schemes of arrangement as long as (i) the scheme is not being proposed by the company to avoid the takeover law found in Chapter 6 of the ACA 2001, and (ii) the Australian Securities and Investment Commission (ASIC) raises no objections. In the UK, there is nothing specific in the legislation to support the emergence of such member schemes in this alternative takeover process but it has been noted is facilitated by the court's interpretation of the statutory provisions.

#### 3.2.4. *Shareholder Voting Model in Schemes*

The UK model demands approval by 75% of those entitled to vote, by headcount, to obtain overall approval of a scheme whereas the law in Australia requires that 75% majority to be determined by their financial stakes and a bare majority by headcount for the scheme to be agreed by members.<sup>38</sup> This provides a means of protecting shareholder rights, especially those with a greater investment in the company, by equating voter value with voting rights. The headcount stipulation may make it difficult for members to attend to vote and, although lacking in Australian Company Law, in the UK Companies Act 2006, sections 321 and 329 provide for 10% of member voting rights, reflecting the value of their investment, to call for a poll. This provides some involvement for otherwise absent foreign investors, although the company articles must allow for such a stipulation.

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<sup>37</sup> Damian and Rich (n 15).

<sup>38</sup> Vijay Cugati, Tom Story and Andrew Wong, 'Public Mergers and Acquisitions in Australia: Overview' (Practical Law 1 March 2017).



The requirement for 75% of voter value was introduced in Australia in 2007 with the aim of preventing potential abuses of power by minority dissenters in the face of majority support, creating classes of voters in an attempt to affect the fate of a scheme when it proved impossible to gain a shareholder value majority.<sup>39</sup>

### 3.2.5. Judicial Discretion of Approval

In the approval process of schemes of arrangement and the exercise of judicial discretion under section 411(17) of the ACA 2001, the Australian courts were somewhat reticent in interpretation of the extent of their powers. In *ACM Gold Ltd* two smaller parts of a larger company sought to be restructured into a third company, Poseidon.<sup>40</sup> The new scheme structure meant Poseidon would acquire a small proportion of the shares in both companies with a cancellation of the remainder in exchange for a 10% shareholding in the newly formed company. The ASIC objected to this member scheme of arrangement on the grounds that it contravened Chapter 6 of the ACA 2001 takeover law, namely that, “as far as practicable, the holders of the relevant class of voting shares or interests all have a reasonable and equal opportunity to participate in any benefits arising from the proposal”.<sup>41</sup> However, O’Loughlin J opined that Chapter 6 of the ACA 2001 did not take priority when there has been appropriate company compliance with a scheme and it is supported by the members, pursuant to Chapter 5, Division 3.<sup>42</sup> The ASIC intervention did not prevent the court from exercising its discretion to approve a scheme. This liberal interpretation of chapter 5 has been followed in a number of other cases with each scheme of arrangement being considered on its own merits.<sup>43</sup>

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<sup>39</sup> The Treasury (Australia), ‘Explanatory Statement to the Exposure Draft of the Corporations Amendment (Insolvency) Bill 2007’ (November 2006) para 4.170

<[http://archive.treasury.gov.au/documents/1302/PDF/ES\\_to\\_the\\_Bill.pdf](http://archive.treasury.gov.au/documents/1302/PDF/ES_to_the_Bill.pdf)> accessed 20 September 2019.

<sup>40</sup> (1992) 7 ACSR 231.

<sup>41</sup> Australian Government Takeovers Panel, ‘Summary of Takeover Provisions in Australia’

<[http://www.takeovers.gov.au/content/DisplayDoc.aspx?doc=panel\\_process/summary\\_of\\_takeover\\_provisions\\_in\\_australia.htm](http://www.takeovers.gov.au/content/DisplayDoc.aspx?doc=panel_process/summary_of_takeover_provisions_in_australia.htm)> accessed 20 September 2019.

<sup>42</sup> Corporations Act 2001, Chapter 5, Division 3, Part 5C.

<sup>43</sup> For example, *Stockbridge Ltd* (1993) 9 ASCR 637 and *Nicron Resources Ltd v Catto* (1992) 10 ACLC 1186.

As a result of the court's liberal interpretative approach, the ASIC and the Australian Takeover Panel are now more flexible, accepting that individual companies have the right to choose their own restructuring mechanism.<sup>44</sup> In *ACM Gold Ltd* that exercise of discretion focused on the company commercial perspective of the scheme rather than an evaluation of its broader impact. Courts should not be overly suspicious of the reasons for choosing a Chapter 5 scheme arrangement over a Chapter 6 takeover process; it is a legally sanctioned choice.<sup>45</sup> It is noted by the Australian Corporations and Market Advisory Committee (CAMAC) that section 411(17) of the ACA 2001 can create a degree of uncertainty about the court's discretionary exercise of approval of a scheme and has recommended its repeal in member schemes.<sup>46</sup>

The three steps of the scheme of arrangement process have the potential to create concerns for the company. It is a relatively complex method of obtaining sanction for restructure, with any sense of urgency to some extent hindered by time and continued corporate loss during the period of transformation. The initial scheme draft proposal presented to the court at the first hearing may not meet the standards of fairness and balance expected by the presiding judge, no matter how objective the company believes it has been and how expensive its legal and accountancy advice has been. Justice Lindgren, in *F Testament & Sons Pty Ltd*, affirmed the importance of procedural compliance to approval.<sup>47</sup> The court will be receptive to approval in those cases where the proposed scheme and its accompanying explanatory treatment provide a fair and complete history which eschews subjectivity and the service of individual interests.

### 3.2.6. Recognition of Foreign Schemes

In the context of recognition of foreign insolvency schemes of arrangement, Australia has adopted the UNCITRAL Model Law in its Cross-Border Insolvency Act 2008 to aid international

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<sup>44</sup> For example, *St Barbara Mines Ltd and Taipan Resources NL* (2000) 18 ACLC 913, 917; see also Takeovers Panel, 'Trust Scheme Mergers' (Guidance Note 15, 2011) 8.

<sup>45</sup> *Rift Valley Resources Ltd* [2012] FCA 952.

<sup>46</sup> CAMAC (n 20) 95-108.

<sup>47</sup> *F Testament & Sons Pty Ltd v Metal Roof Decking Supplies Pty Ltd* (1977) 3 ACLR 69, 72, and see Christopher Pilkington, *Schemes of Arrangement in Corporate Restructuring* (Sweet and Maxwell 2013) 71-72.

harmonisation for the promotion of business.<sup>48</sup> Nevertheless, harmony between jurisdictions in the recognition of foreign schemes does not result in full comity as Australian courts closely follow the decisions of those in the UK.<sup>49</sup> In the restructure of the International Bank of Azerbaijan, the English Court of Appeal refused to recognise the foreign release of creditor claims where they were governed by English law. Liabilities in bankruptcy can only be discharged if they are properly governed by the law of the country where the liquidation occurs.<sup>50</sup> Further, this will militate against Australian courts being able to approve an insolvency scheme in its jurisdiction where there are concerns about its enforcement in the UK, except where the English creditor is positively engaged in the decision-making process.<sup>51</sup>

In the context of recognition of corporate rehabilitation schemes, note is taken of Article 8 of the Model Law, which states that, “in the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith”.<sup>52</sup> The Model Law is not based on reciprocity of recognition but the Australian government has appreciated that the law should facilitate the operation of corporate bodies reorganised in other jurisdictions, and will do so upon satisfaction that the rights of creditors have been protected in accordance with that foreign law.<sup>53</sup>

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<sup>48</sup> Robert McDougall, ‘Recognition of Foreign Insolvency Proceedings – An Australian Perspective’ (Paper prepared for the 31st LAWASIA Conference, Siem Reap, Cambodia 3 November 2018) <[http://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Speeches/2018%20Speeches/McDougall\\_20181103.pdf](http://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Speeches/2018%20Speeches/McDougall_20181103.pdf)> accessed 20 September 2019.

<sup>49</sup> David Walter, ‘Australia: The Limits of Recognition under the UNCITRAL Model Law – Foreign Compromises of English Law Claims’ (Baker McKenzie 28 February 2018) <<http://restructuring.bakermckenzie.com/2018/02/28/australia-the-limits-of-recognition-under-the-uncitral-model-law-foreign-compromises-of-english-law-claims/>> accessed 20 September 2019.

<sup>50</sup> Ian Fletcher, *The Law of Insolvency* (5<sup>th</sup> edn, Sweet & Maxwell 2017) para 30-061. This discusses the ‘Rule in *Antony Gibbs*’ – *Antony Gibbs and Sons v Societe Industrielle et Commerciale des Metaux* (1890) 25 QBD 399. Confirmed in *Bakhshiyeva v Sberbank of Russia and Others* [2018] EWCA Civ 2802. Also, see Kay V. Morley and Sarah Archer, ‘UK: English Court of Appeal Upholds “The Gibbs Rule”’ (Jones Day 28 February 2019) <<http://www.mondaq.com/uk/x/785876/Insolvency+Bankruptcy/httpwwwmondaqcomarticleasparticleid785874>> accessed 20 September 2019.

<sup>51</sup> Walter (n 49).

<sup>52</sup> UNCITRAL, ‘Model Law on Recognition and Enforcement of Insolvency-Related Judgments’ (UNCITRAL 2 July 2018) <[http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/1997Model.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html)> accessed 20 September 2019.

<sup>53</sup> The Treasury (Australia), ‘Enacting the UNCITRAL Law in Australia: Issues for Consideration’ (Australian Government, CLERP Paper No. 8: Proposals for Reform – Cross-Border Insolvency 2002)

### 3.3. Canada

Canada has adopted into law two forms of scheme of arrangement. The first is entirely supervised by the court, introduced by section 192 of the Canadian Business Corporations Act 1985 (CBCA 1985) and is noted for its brevity.<sup>54</sup> It consists of just two operative provisions. Section 192(3) states that:

“Where it is not practicable for a corporation that is not insolvent to effect a fundamental change in the nature of an arrangement under any other provision of this Act, the corporation may apply to a court for an order approving an arrangement proposed by the corporation.”<sup>55</sup>

Then section 192(4) establishes the power of the courts by specifically outlining parameters, whilst also allowing final or interim orders to be made at the court’s discretion. British schemes are predicated on a set of information typologies, disclosure, voter class distinctions et al, which must be provided for in the scheme process, closely regulated by UK statute whereas the Canadian statutory provision is silent on the procedural rules which must be complied with to gain approval.<sup>56</sup> MacIntosh, in 1989, shortly after Canada introduced much of its legislative provision on corporate reorganisation and creditor arrangements, noted that legislation meant courts became less reticent in adopting a liberal interpretation and application of the law to facilitate fundamental changes to corporate restructure.<sup>57</sup>

#### 3.3.1. Jurisdiction Limitations re Foreign Company Applications

Where proceedings for insolvency or debt reorganisation are instituted under the Bankruptcy and Insolvency Act 1985, the company must file its application in the ‘locality of the debtor’ as per section 43(5). This is the principal base of the company’s business immediately preceding

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<<https://treasury.gov.au/publication/clerp-paper-no-8-proposals-for-reform-cross-border-insolvency/enacting-the-uncitral-law-in-australia-issues-for-consideration/>> accessed 20 September 2019.

<sup>54</sup> Simon Scott, Timothy Buckley and Andrew Harrison, ‘The Arrangement Procedure under Section 192 of the Canada Business Corporations Act and the Reorganization of Dome Petroleum’ (1990) 16 Canadian Business Law Journal 296, 299-300.

<sup>55</sup> Canadian Business Corporations Act 1985, Section 192(3).

<sup>56</sup> Larelle Chapple, Peter Clarkson and Daniel Hutchinson, ‘To Scheme or Not to Scheme: Perceptions of Schemes of Arrangement Takeovers’ (6 August 2009) <<https://ssrn.com/abstract=1444744>> accessed 20 September 2019.

<sup>57</sup> Jeffrey G MacIntosh, ‘Minority Shareholder Rights in Canada and England: 1860-1987’ (1989) 27(3) Osgoode Hall Law Journal 561, 568.

the bankruptcy or where the larger parts of its assets are located (section 2(1)). This does not, however, require actual incorporation in the specific court jurisdiction. In *Nortel Networks Corp*, the Ontario Court of Appeal decided that, for the purposes of the scheme to protect the debtor company, section 2(1) meant the location where the major corporate decisions were made, employee affairs managed and marketing and communication functions exercised.<sup>58</sup>

*Prima facie*, this suggests that, in order to enable access to the benefits of the restructuring of debt liabilities which is aimed at ensuring survival, a company must essentially be Canadian. This poses a problem for multinational corporations which are composed of entities based in foreign jurisdictions as well as Canada. Zumbro has noted that where the whole business is at risk, a requirement to use different jurisdictions for rescue scheme purposes may result in a diversity and inconsistency of results and an increase in enforcement confusion and business peril.<sup>59</sup>

Canada has incorporated the UNCITRAL Model Law on Cross-Border Insolvency 1997 into its Bankruptcy and Insolvency Act and in the case of restructure schemes, the Companies' Creditors Arrangement Act 1985 (CCAA 1985), albeit with modifications to protect its own sovereign court discretion. However, Glinic suggests that this does not bring a satisfactory resolution to the base of operations restriction placed by Canadian law on administering applications for liquidation or restructure.<sup>60</sup> Nortel's demise was dealt with in part in Canada and England, so "the potential for appeal in each jurisdiction only heightens the concern that the allocation issue will remain unresolved for some time".<sup>61</sup> At the time of this study, the jurisdiction issue for institution of proceedings remains in need of resolution.

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<sup>58</sup> Vanja Ginic, 'Nortel Allocation Proceedings: Making the Case for Arbitration in Cross Border Insolvency' (University of Ottawa 2015) <<https://www.insolvency.ca/en/whatwedo/resources/Nortel-TheCaseforArbitrationinCrossBorderInsolvencybyVanjaGinic.pdf>> accessed 20 September 2019.

<sup>59</sup> Paul H Zumbro, 'Cross-border Insolvencies and International Protocols – An Imperfect but Effective Tool' (2010) 11 *Business Law International* 157, 161.

<sup>60</sup> Ginic (n 58) 9.

<sup>61</sup> *ibid* .

### 3.3.2. International Recognition of Restructure Arrangements

The adoption of the Model Law also impacts on recognition of foreign schemes involving Canadian companies outside of the jurisdiction, and indeed foreign restructured companies which have done business and incurred liabilities in the territory. Indeed, in *Nortel* the Canadian Court of Appeal recognised and gave effect to the English and American law parts of the scheme entered into by the multinational corporation on its dissolution in 2009.<sup>62</sup> Fogarty et al note the Canadian courts are prepared to exercise jurisdiction over non-Canadian companies where their main operation is in the territory, and so will assist in the enforcement of foreign orders where they have such access to the target assets.<sup>63</sup> This constitutes recognition of its obligations under the Model Law and is essential to the recognition of foreign orders where they affect the jurisdiction.

In 2018, the Third Circuit of the US Court of Appeals upheld arrangements made in Canada arising from the liquidation scheme under the CCAA 1985 of the Canadian company *Artic Glacier International Inc (AGIF)* which involved distributions and releases from financial obligations to American creditors.<sup>64</sup> A monitor had been appointed in the 2012 proceedings to provide the company with protections afforded by the Chapter 15 procedures in America and to ease recognition of the Canadian arrangements. Although the distributions under the plan violated Financial Industry Regulatory Authority rules, the plan's distribution was deemed to supersede such conflicting obligations and was binding on the buyers and barred their claims.<sup>65</sup>

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<sup>62</sup> Jeff Buckstein, 'Leave to Appeal Ontario Nortel Ruling Declined' (The Lawyers Weekly 27 May 2016) 5 <[https://www.blaney.com/files/20857\\_TheLawyersWeekly-DavidUllmannNORTEL.pdf](https://www.blaney.com/files/20857_TheLawyersWeekly-DavidUllmannNORTEL.pdf)> accessed 20 September 2019.

<sup>63</sup> Justin R Fogarty, Pavle Masic and Jason Dutrizac, 'Insolvency and Directors' Duties in Canada: Overview' (Practical Law 1 December 2016).

<sup>64</sup> Mark A Salzberg, 'Third Circuit Makes Clear that Plan Releases Can Extend to Post-Confirmation Acts' (The National Law Review 17 September 2018) <<https://www.natlawreview.com/article/third-circuit-makes-clear-plan-releases-can-extend-to-post-confirmation-acts>> accessed 20 September 2019.

<sup>65</sup> Michael Vatcher, 'Third Circuit Holds that Share Purchasers Take Shares Subject to Plan, Including Releases of Liability for Debtor's Post-Confirmation Acts' (Kramer Levin 18 October 2018) <[https://www.kramerlevin.com/en/perspectives-search/third-circuit-holds-that-share-purchasers-take-shares-subject-to-plan-including-releases-of-liability-for-debtors-post-confirmation-acts.html?utm\\_source=Mondaq&utm\\_medium=syndication&utm\\_campaign=LinkedIn-integration](https://www.kramerlevin.com/en/perspectives-search/third-circuit-holds-that-share-purchasers-take-shares-subject-to-plan-including-releases-of-liability-for-debtors-post-confirmation-acts.html?utm_source=Mondaq&utm_medium=syndication&utm_campaign=LinkedIn-integration)> accessed 20 September 2019.

This included claims made for subsequent acts the court considered *res judicata* in the original plan. It has been noted in this study that the opinion of other sovereign judicial jurisdictions cannot be guaranteed insofar as recognition of foreign orders and arrangements are concerned. However, the receipt of expert advice, interactive consultation and cooperation, as well as being a signatory to international comity provisions, will provide a substantial degree of certainty.

### 3.3.3. Scheme of Arrangement Procedure

The CBCA 1985 does not provide for a legal structure which demands specific details of the scheme plan, supporting documentation, voting requirements, for example, to be included in the proposal. Nevertheless, the court process, as defined by judicial practice and expectation, is similar to the English procedure.<sup>66</sup> When a scheme of arrangement is sought, an application is made to the court for an interim order which serves as notice to all interested members and creditors that they are required to attend a meeting if they wish to have their vote counted. Following the proposal of a scheme of arrangement, an interim order is granted by the court to authorise a meeting of the company's members and creditors in their correct classes to take place, thus serving as a prerequisite for the vote on the scheme.

The number of votes required for approval is not set out in the Canadian state or indeed federal statute. The general rule, administrative by nature and based on the common law of individual states in the application of the 'special majority' provisions, is that there must be a two-thirds majority of attendees at the meeting in favour, by headcount.<sup>67</sup> In some parts of the territory, such as British Columbia, a minimum of 75% voter approval is demanded before the court will sanction a scheme.<sup>68</sup> The Canadian approach, especially in the case of schemes involving huge corporate entities with a profoundly diverse voting membership, is arguably more pragmatic

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<sup>66</sup> Payne (n 26) 341.

<sup>67</sup> Industry Canada, 'Policy Statement 15.1: Policy Concerning Arrangements under Section 192 of the Canada Business Corporations Act' (Industry Canada, 4 January 2010) para 3.10.

<sup>68</sup> See British Columbia Company Act 1979.

than the UK's fixed rule of 75% of entitled voters, where a requisite majority quorum is logistically problematic to arrange in a meeting venue.

Once the scheme of arrangement has been approved by this vote, no objections are taken into account and the scheme resubmitted to court to obtain final approval. At this stage, the court must, in the exercise of its discretion ensure that: (i) all of the statutory requirements have been met; (ii) that the scheme of arrangement has been proposed and approved in good faith; and (iii) that it is fair and reasonable.<sup>69</sup> The determination of a scheme of arrangement as fair and reasonable refers to whether a fair balance is achieved between the scheme and the company's circumstances as they affect members and creditors.<sup>70</sup> Although the court may consider a vote by company shareholders and creditors in favour of a scheme of arrangement as persuasive evidence for approval, it is not conclusive. The reasonableness assessment falls to the judge and section 192(7)-(8) of the CBCA 1985 requires the independent Director of Corporations in Canada to issue a Certificate of Arrangement to demonstrate support for a proposed and approved restructure scheme, this playing a major role in the court's findings and approval. The Director indeed has the right to make submissions and appear before the court when an application for final approval of a scheme has been submitted to the court to express his or her views, per section 192(5).

### 3.3.4. *Minority Shareholders Rights and Powers*

Canadian law affords minority shareholders substantially more influence and power in the approval procedure of a scheme of arrangement proposed by the company in comparison to that exercised by their British counterparts, who are effectively compelled to accept the majority decision.<sup>71</sup> In the other corporate restructuring mechanisms such as takeovers, minority shareholders in the UK have limited benefit and protection against the potentially

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<sup>69</sup> *BCE Inc v 1976 Debentureholders* (2008) SCC 69, 137. See also *TrizecCorp* [1994] AJ No 577, 13 and *St Lawrence & Hudson Railway Co* [1998] OJ No 3934, 12-14.

<sup>70</sup> Payne (n 26) 334.

<sup>71</sup> Scott Clune, 'Amalgamations, Schemes of Arrangement and Takeovers Regulation: Concerns of the Takeovers Panel and the Need for Reform' (2007) 13 *Canterbury Law Review* 91, 94-95.



abusive exercise of power by the majority under the terms of the Takeover Directive 2004.<sup>72</sup> Section 190 of the CBCA 1985 gives minority shareholders the right to express their concerns regarding the scheme of arrangement by issuing an order of dissent at the final hearing, prior to the announcement of the court's decision about whether the scheme is fair and reasonable. Those who disapprove of the scheme also have the right to offer their shares for sale at a fair market-based value.<sup>73</sup> This provides minority shareholders with a voice to air their concerns about a scheme of arrangement and also provides them with a remedy.

A company may seek to exploit the flexibility of a scheme of arrangement to avoid the strict requirements of other legislative restructuring methods. This is a legitimate, legal and strategic choice, and there must be a presumption, unless there is evidence otherwise, that the officers-management act in the best interests of the company, even in the event of harm to shareholders. After all, directors have no specific obligation to shareholders but must only consider the best interests of the corporation.<sup>74</sup> Whilst there may be a tendency to suspect ulterior motive in undertaking a scheme which carries less court scrutiny a company may more quickly exit a period of financial distress without the public stigma of pending liquidation and its effect on the share price.<sup>75</sup> In Canada, section 192(3) of the CBCA 1985 states that proceeding with restructure by way of a scheme is acceptable "where it is not practicable for the transaction to be carried out under any other provision". What is 'practicable' is likely to be a tactical decision for the directors in the interests of the company. The Director of Corporations has asserted that companies may employ the scheme of arrangement as a corporate restructuring mechanism to effect a takeover, especially where it can argue the alternative would significantly disrupt its operations and functions.<sup>76</sup> The statute may suggest that, in the absence of financial distress, the member scheme of arrangement is limited in use by specific legislative alternatives, although the practice of commerce and the courts is broad acceptance.

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<sup>72</sup> Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids [2004] OJ L142/12.

<sup>73</sup> CBCA 1985, Section 190(26).

<sup>74</sup> Fogarty, Masic and Dutrizac (n 63).

<sup>75</sup> Paul Casey and Martin McGregor, 'CBCA Section 192 Restructurings: A Streamlined Restructuring Tool or a Statutory Loophole?' (Annual Review of Insolvency Law, 11<sup>th</sup> Conference 20-21 February 2013) para 20.

<sup>76</sup> Industry Canada (n 67) para 2.06.

Indeed, although there are several options for dealing with the threat of insolvency, section 192(3) of the CBCA 1985 states that a solvent company may propose a scheme of arrangement. Insolvent companies are *prima facie* excluded from such a measure, having reached the stage of impending dissolution; their obvious option for restructure is the CCAA 1985. In recent years, however, in a number of adjudications, the courts have confirmed that insolvent companies may avail themselves of the scheme option under the CBCA 1985.<sup>77</sup> The solvency requirements of section 192(3) of the CBCA 1985 are satisfied as long as at least one of the parties proposing the scheme is solvent, or at least will be by the time the final arrangement was to be submitted<sup>78</sup> or the company is likely to become solvent on implementation of the scheme. It is a liberal imaginative and pragmatic approach which expands the CBCA 1985 framework to embrace and reflect commercial needs, its broad interpretation adopted by the Canadian government as essential to economic policy and development.<sup>79</sup>

The Canadian CBCA 1985 offers a greater measure of autonomy to companies, members and creditors with respect to debt restructuring than current UK legislation. It allows key stakeholders, particularly management officers who possess unique knowledge and insight of the company, to steer planning, strategy and decision-making, rather than external monitors, administrators or trustees under bankruptcy and creditor arrangement legislation.<sup>80</sup> Indeed, the latter agencies would encumber the insolvent company with bureaucratic requirements that would both complicate and lengthen the process in question and the section 192 CBCA procedure considerably reduces court interventions.<sup>81</sup> It is more efficient than the CCAA 1985 given that the period from the interim order to the final scheme approval is generally less than 30 days, 75 if the arrangement and company affairs are more complex.<sup>82</sup>

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<sup>77</sup> For example, *In the Matter of a Proposed Arrangement involving Ainsworth Lumber Co Ltd, Ainsworth GP Ltd and Ainsworth Engineered Canada Limited Partnership* (20 July 2008) No S-084425, *In the Matter of a Proposed Arrangement by Abitibi Consolidated Inc* (2009) QCCS 6444 and *In the Matter of a Proposed Arrangement concerning Yellow Media Inc et al* (2012) QCCS 4180.

<sup>78</sup> *St Lawrence & Hudson Railway Co* [1998] OJ No 3934.

<sup>79</sup> Industry Canada (n 67) para 1.02.

<sup>80</sup> Casey and McGregor (n 75) para 1.

<sup>81</sup> *ibid.*

<sup>82</sup> Milly Chow and Marc Flynn, 'Alternative Restructurings: Strategies, Challenges and Pitfalls' (2011) 26(2) National Creditor Debtor Review 13, para 14.

Canada's foundation as a common law jurisdiction makes it amenable to adaptation to changes in social, economic and legal evolution in a fluid global market, where companies demand flexibility in legal processes which facilitate flexibility with authority and recognition. The jurisdiction, like the UK, provides corporate choice in the pursuit of survival and growth, methods of reorganisation of its structural and financial affairs to meet the challenges of the international competitive market.<sup>83</sup>

Business investment comes with risk and the scheme of arrangement will often require some sacrifice on the part of creditors, a compromise in the greater interests of the company and its future trading capacity. In the context of the law as a service provider, the jurisdictions of both Canada and the UK stress the principles of fairness and reasonableness, but the concept of majority control is respected with more limited protection for corporate dissenters. The scheme of arrangement is not a simple transplant from one Commonwealth member to another, but reflect the cultural, economic and commercial development of each, diverse nation in its different spheres of operation and trade.<sup>84</sup>

### **3.4. Germany**

Germany is an independent constitutional democracy with a civil code framework predicated on statute. It has no common law/judicial precedent-based law process, which is fundamental to the interpretive structure of law in the UK and its Commonwealth. As a member of the EU, the rights of establishment and harmonisation provision of the Union regulate relationships with other states. Regulation (EU) 1215/2012, for example, provides that "a judgment given in a Member State shall be recognised in the other Member States without any special procedure being required".<sup>85</sup>

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<sup>83</sup> Canadian Government, 'Fresh Start: A Review of Canada's Insolvency Laws' <<https://www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/cl00882.html>> accessed 20 September 2019.

<sup>84</sup> Jan D Weir, *Critical Concepts of Canadian Business Law* (Pearson 2016) 89-90.

<sup>85</sup> Regulation 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast) [2012] OJ L351/1.

McCormack states that the corporate restructure proposals under the Europe 2020 Strategy will apply to all Member States and envisages 'economic recovery' and 'sustainable growth'.<sup>86</sup> The objective of the strategy is to create a situation where economic and social systems across the Union are adaptable, harmonious, resilient and fair and where human values are respected.<sup>87</sup> The European Commission suggests this is the route to sustainable, inclusive economies that promote employment and social cohesion.<sup>88</sup> Saving potentially viable businesses from insolvency requires a flexible, speedy restructure process in law, access to broad capital markets and sources of refinancing, deepening financial integration and increasing certainty for investors and companies. The Commission notes that there are currently 28 different insolvency regimes operating in the EU. An aim of the proposals is therefore to facilitate harmony of provisions.<sup>89</sup>

The national laws of EU Member States may not offer a coalescence of terms; the EU's strength is in its cohesion and comity. The definition of a 'judgment' under Regulation (EU) 1215/2012 includes adjudications of English courts and will, therefore, draw into the approval and enforcement process those foreign companies able to secure the jurisdiction under its broad interpretation.<sup>90</sup> However, the UK will no longer be an automatic adherent to the EU Regulations in the absence of an agreement to leave the Union.

This has a further potential effect on the recognition of German schemes of arrangement. In the broader global jurisdictions, Germany is not a signatory of the UNCITRAL Model Law on Cross Border Insolvency.<sup>91</sup> This, it is emphasised, is not a bar to mutual foreign recognition of

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<sup>86</sup> Gerard McCormack, 'Business Restructuring Law in Europe: Making a Fresh Start' (2017) 17(1) *Journal of Corporate Law Studies* 167.

<sup>87</sup> Commission, 'Communication from the Commission: Europe 2020 – A Strategy for Smart, Sustainable and Inclusive Growth' COM (2010) 2020 final.

<sup>88</sup> *ibid* 3.

<sup>89</sup> Gerard McCormack and others, 'Study on a New Approach to Business Failure and Insolvency: Comparative Legal Analysis of the Member States' Relevant Provisions and Practices' (European Commission January 2016) <[https://ec.europa.eu/info/sites/info/files/insolvency\\_study\\_2016\\_final\\_en.pdf](https://ec.europa.eu/info/sites/info/files/insolvency_study_2016_final_en.pdf)> accessed 20 September 2019.

<sup>90</sup> Ian Jack and Anthony Hewitt, 'England and Wales: Update – Will Brexit Kill Schemes of Arrangement?' (Baker McKenzie 12 July 2017).

<sup>91</sup> The In-House Lawyer, 'Will a Local Court Recognise Concurrent Foreign Restructuring or Insolvency Proceedings over a Local Debtor? What Is the Process and Test for Achieving such Recognition? Has the UNCITRAL Model Law

insolvency restructure. Germany will recognise and enforce the orders of foreign jurisdictions where there is no fundamental incompatibility with national legal principles.<sup>92</sup>

Although Germany is central to the operation and success of the EU economy and growth its approach to corporate restructuring it has limited experience of the law relating to restructure via a scheme of arrangement outside of its insolvency utility. One of the key problems with the German approach is that a scheme of arrangement is only implemented after formal insolvency proceedings have been commenced. German companies have utilised the English legal system to effect their corporate restructuring. *PrimaCom Holding GmbH*, for example, was a reorganisation of a multi-company entity to rationalise the group finances,<sup>93</sup> *Rodenstock GmbH* related to solvent debt refinancing,<sup>94</sup> and *Apcoa* was a proposal for debt reduction.<sup>95</sup>

German schemes of arrangement tend to be perceived as a tool of corporate insolvency when it is arguably too late to save the company as a viable business entity, rather than broader restructuring process before reaching the point of financial desperation. Indeed, this disincentive for members is matched by a formal court driven procedure which makes substantial, voluntary, out-of-court restructurings complex to manage and more easily challenged by individuals who wish to obstruct the proposals.<sup>96</sup>

Schemes of arrangement are principally legislated for in section 27 of the Insolvency Code 1994 (*Insolvenzordnung, InsO*) authorising the procedure to be implemented for any restructuring mechanism, in the event of insolvency, commenced before the insolvency court which is

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on Cross Border Insolvency Been Adopted or is it under Consideration in your Country?' - Germany <[http://www.inhouselawyer.co.uk/wgd\\_question/will-a-local-court-recognise-concurrent-foreign-restructuring-or-insolvency-proceedings-over-a-local-debtor-what-is-the-process-and-test-for-achieving-such-recognition-has-the-uncitral-model-law-on/](http://www.inhouselawyer.co.uk/wgd_question/will-a-local-court-recognise-concurrent-foreign-restructuring-or-insolvency-proceedings-over-a-local-debtor-what-is-the-process-and-test-for-achieving-such-recognition-has-the-uncitral-model-law-on/)> accessed 20 September 2019.

<sup>92</sup> Michael Bütter, 'Cross-Border Insolvency under English and German Law' (Oxford University Comparative Law Forum 2002) Ch 2 <<https://ouclf.iuscomp.org/cross-border-insolvency-under-english-and-german-law/>> 20 September 2019.

<sup>93</sup> [2011] EWHC 3746 (Ch).

<sup>94</sup> [2011] EWHC 1104 (Ch).

<sup>95</sup> [2014] EWHC 997 (Ch).

<sup>96</sup> Reinhard Bork, 'The German Discussion on the Introduction of a Pre-insolvency Regime' (Oxford Business Law Blog 20 June 2016) <<https://www.law.ox.ac.uk/business-law-blog/blog/2016/06/german-discussion-introduction-pre-insolvency-regime>> accessed 20 September 2019.

responsible for its orderly end. It involves the creation of a creditors' committee which will call a meeting to discuss and present a proposal on the distribution of remaining corporate assets.<sup>97</sup> Creditors are allocated into voting groups according to their category through the nature of their statutory hierarchy and security.<sup>98</sup> The restructure, essentially a distribution of remaining assets, may be standardised, pre-packed, to facilitate sale of all or parts of the company, and include staff reductions to sell the potentially profitable parts of the business.<sup>99</sup> Alternatively, the company may make proposals specific to its creditors to allow for a restructuring to deal with a particular debt issue and seek to preserve the business as a going concern. These options still carry publicity and stigma, and a resulting share value and market reputation loss. The German insolvency court will supervise the process followed by the company, making preservation of assets orders and monitoring corporate actions,<sup>100</sup> to ensure that the restructuring proposals presented by the company and accepted or rejected by the company's creditors have been followed according to legislative and financial demands. The creditors committee will cooperate fully with the administrator of the corporate estate and monitor their work.<sup>101</sup>

Several concerns arise from this, not least that the requirement of insolvency proceedings means a choice of venue between no fewer than 116 different such courts, emphasising risks of lack of consistency in decision-making and resultant unpredictability in judicial adjudication.<sup>102</sup> As is the case with the UK, international companies seeking to rely on the German jurisdiction to effect insolvency restructure must be able to demonstrate a sufficient degree of connection with the country, thus avoiding forum shopping when their domicile of business is less amenable to their corporate plans for asset distribution.<sup>103</sup> It is not, however, a particularly attractive legal system within which to effect liquidation. The *Insolvenzordnung* is time-

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<sup>97</sup> Sections 68-79, Insolvency Code.

<sup>98</sup> Section 28, Insolvency Code.

<sup>99</sup> Frank Frind and Frank Pollmächer, 'Comments on the Pre-Insolvency Proceedings Proposal in Grabenbrüche District Germany – Think Twice, Before it's All Right' (2016) 19(26) *Zeitschrift für das gesamte Insolvenzrecht* 1290-1294.

<sup>100</sup> Sections 157, 160 and 162, Insolvency Code.

<sup>101</sup> *ibid*, Sections 69, 261(3), 232(1) No 1 and 233.

<sup>102</sup> Gravenbrucher Kreis, *Pre-insolvency Restructuring Proceedings in Germany* (ZIP 2016) 1208-1210.

<sup>103</sup> *ibid*.

consuming given the oversight and direction of the court, requiring strict timetable adherence, yet permitting company creditors be given between three to six months to review the proposals before being called into a creditor's meeting to vote.<sup>104</sup>

The final consideration, for the purposes of this analysis, is perhaps most pressing for multi-corporate entities composed of a group of companies. Schotte and Grotebrune note that: "German company law is based on a doctrine comparable to that established in *Salomon v Salomon* in the UK. Each corporate entity is therefore dealt with in separate insolvency proceedings. German law does not recognise the concept of group insolvency".<sup>105</sup> It is an expensive duplication of actions, from separate issue of proceedings, gatherings of creditors and voting procedures, with the capacity for a diverse range of assent-dissent results across a range of court territorial jurisdictions arising from individual places of business. EU Regulation 2015/848 seeks to ameliorate the problems caused by this dispersal of corporate entities within a single umbrella company by concentrating proceedings relating to insolvency in a 'Centre of (debtor's) Main Interests' (COMI).<sup>106</sup> The objective identification of the central administration of the company as a whole will determine, it is suggested, jurisdiction in the German context to enable creditors to look for "the 'brain' of the company, not for the 'muscles', the actual centre of management".<sup>107</sup>

Given that Germany is not an attractive venue for restructure, even for domestically registered companies, the free access to the business market in the EU region, and the profoundly liberal view of the UK courts to jurisdiction, it is of little surprise that the English courts are, at present, the venue of choice for rearrangement of affairs. However, the German Federal Court of Justice has cast doubt on the future ability of German companies to engage in forum shopping by

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<sup>104</sup> Section 25, Insolvency Code.

<sup>105</sup> Christoph Schotte and Björn Grotebrune, 'Insolvency and Directors' Duties in Germany: Overview' (Practical Law 1 January 2018) <[https://uk.practicallaw.thomsonreuters.com/9-607-7545?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/9-607-7545?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1)> accessed 20 September 2019.

<sup>106</sup> Regulation 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings [2015] OJ L141/19, para 23.

<sup>107</sup> Francisco Garcimartin, 'The EU Insolvency Regulation Recast: Scope and Rules on Jurisdiction' (University Autónoma of Madrid 24 March 2016) 8 <[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2752412](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2752412)> accessed 20 September 2019.

refusing to recognise the legitimacy of a scheme approved in the UK. In *Equitable Life*,<sup>108</sup> it was decided that schemes approved in another jurisdiction, such as the UK, had to be compliant with the *Insolvenzordnung* for recognition of its effects on, for example, the rights of members and creditors.<sup>109</sup> The scheme has to be comparable and compatible with the aims of German legislation, and given that the Equitable Life plan prejudiced the protected rights of a policyholder in Germany, and was not predicated on insolvency, it failed to be recognised.<sup>110</sup>

The recognition of the orders and judgements of EU members is predicated on Council Regulation (EC) No 44/2001 of 22 December 2000<sup>111</sup> and it would *prima facie* appear to be a failure of that provision. Although not strictly pertinent to this national law analysis, the Regulation was also found by the Federal Court to have been breached Article 12(1) thereof because insurance policy creditors must be dealt with by the jurisdiction in which they are based.<sup>112</sup> This finding is, in the context of the recognition of other schemes recognised noted above, of limited importance. It is not a portent of weakness, an end to the harmony of the Union, but is based on a specific insurance policy issue<sup>113</sup> which the UK courts appeared to overlook.

The future development of schemes of arrangement need to have a degree of correspondence with the national procedures and protections of others before being of universal applicability and its outcomes recognised by member jurisdictions. Gerner-Beuerle and Schuster there is a degree of friction that exists between company and insolvency law and the operation of the

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<sup>108</sup> IV ZR 194/09 Der Bundesgerichtshof (15 February 2012).

<sup>109</sup> Frank Frind and Frank Pollmächer (n 99) 1290-1294.

<sup>110</sup> Richard Tett and Marvin Knapp, 'German Federal Court Rules on the Equitable Life Scheme of Arrangement' (2012) 9(6) International Corporate Rescue <<http://www.chasecambria.com/site/journal/article.php?id=670>> accessed 20 September 2019.

<sup>111</sup> Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters [2000] OJ L12/1.

<sup>112</sup> Stefan Sax and Cristina Weidner, 'Insolvency & Restructuring – Germany: Court Refuses to Recognise an English Scheme of Arrangement' (Clifford Chance 3 August 2012) <<https://www.cliffordchance.com/content/dam/cliffordchance/PDFDocuments/Court%20refuses%20to%20recognise%20an%20English%20scheme%20of%20arrangement%20-%203%20August%202%20%20.pdf>> accessed 20 September 2019.

<sup>113</sup> *ibid.*



Single Market,<sup>114</sup> although this is overstated in the case of the *Equitable Life* judgment of 2012. Harmony in the law and recognition of the outcome new company with rearranged obligations must accommodate national differences in the EU. This has been somewhat achieved in the recognition of insolvency orders from member states with cross-border assets and interests.<sup>115</sup> It is worth noting this Regulation would not have altered the *Equitable Life* judgment, not only because the company was not insolvent but also because “insurance undertakings, credit institutions, investment firms and other firms, institutions or undertakings” are excluded from anything other than corporate domicile orders.<sup>116</sup> Developments in the EU legislative process, particularly the 2015 Regulations noted above, have not drawn schemes of arrangement into the COMI provisions, arguably because they deal only with insolvency matters.<sup>117</sup> This should not, it is suggested, prevent the umbrella company from entering into negotiations for restructure using the more flexible procedure, particularly in the absence of financial distress indicators.

### 3.5. Hong Kong

The approach to schemes of arrangement in Hong Kong also shares similarities with that of the UK, largely as a result of the fact that Hong Kong was a former British colony and under the governance of the Crown until 1997. Hong Kong is arguably insular in its dealings with insolvency restructure, given that it has not adopted the UNCITRAL Model Law on Cross-border Insolvency. There is no legislation which facilitates recognition of, or assistance in, the insolvency procedures of other jurisdictions although the courts have taken what may be termed a pragmatic approach to such events, particularly where there is a ‘sufficient connection’ with the jurisdiction.<sup>118</sup> Hong Kong will sanction schemes of arrangement on a similar basis to the English rules where there is sufficient connection to the jurisdiction,

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<sup>114</sup> Carsten Gerner-Beuerle and Edmund Schuster, ‘The Costs of Separation: Friction Between Company and Insolvency Law in the Single Market’ (2014) 14(2) *Journal of Corporate Law Studies* 287, 289.

<sup>115</sup> Regulation 2015/848 (n 106).

<sup>116</sup> *ibid* para 19.

<sup>117</sup> Garcimartin (n 107).

<sup>118</sup> Tanner DeWitt, ‘Overview of the Insolvency Regime in Hong Kong’ (International Comparative Legal Guide to: Corporate Recovery and Insolvency, Global Legal Group 2011) <<https://www.tannerdewitt.com/overview-of-the-insolvency-regime-in-hong-kong/>> accessed 20 September 2019.

although there are no definitive criteria on how this is established.<sup>119</sup> Such is the level of correlation with English law that the Hong Kong courts may look to the residence of shareholders, relationships with local customers and businesses and extent of contribution to corporate revenue in order to establish sufficiency, as per *Rodenstock GmbH*.<sup>120</sup>

The legislation providing for schemes of arrangement is set out in section 166 of the Hong Kong Companies Ordinance 2012 (HKCO 2012) whereby the company or its liquidator, or any creditor or member, may apply to the court for a meeting of members or creditors as the court directs. Where three-quarters of those attending in person or by proxy support the arrangement, it will be sanctioned by the court.<sup>121</sup>

Reflecting its British corporate law influence, section 161(1) is applied to ensure the arrangement of an initial court hearing to convene members and creditors voter meetings, arranged by classification of interests and rights, as the first step toward scheme approval as set out in *Industrial Equity (Pacific) Ltd*.<sup>122</sup> Such are the similarities in the regulatory procedures that Lord Millett in *UDL Holdings Ltd*<sup>123</sup> stated that precedent adjudications in the case law of the UK carry 'great weight' in Hong Kong schemes. Stakeholders in both jurisdictions may challenge the lawfulness of a scheme until such time as the final court hearing sanctions it.

The HKCO 2012 came into force in 2014, making significant changes to the law of corporate governance, and, for the purposes of this review, the practice of the court's approval of schemes following the final vote of approval. The particular concern of the Hong Kong government was the effect of the minimum headcount requirement on the company member-stakeholder on formal scheme approval.<sup>124</sup> The court in *PCCW Ltd* had expressed concerns that

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<sup>119</sup> Ian Mann, Chai Ridgers and Jennifer Maughan, 'Hong Kong: Schemes: Recognition or Parallel Schemes of Arrangement' (Mondaq 2 July 2015) <<http://www.mondaq.com/hongkong/x/407494/Insolvency+Bankruptcy/Schemes+Recognition+Or+Parallel+Schemes+Of+Arrangement>> accessed 20 September 2019.

<sup>120</sup> *Rodenstock GmbH* (n 94).

<sup>121</sup> Hong Kong Companies Ordinances 2012, Sections 670-674.

<sup>122</sup> [1991] 2 HKLR 614.

<sup>123</sup> [2002] 1 HKC 172, para 23.

<sup>124</sup> Financial Services and Treasury Bureau, *Rewrite of the Companies Ordinance* (Financial Services and Treasury Bureau 2009) Ch 3.

minorities were effectively squeezed-out by the majority in the headcount procedure who, in the implementation of the voting requirement, manipulated the classification of members to ensure dissenters influence was prejudiced.<sup>125</sup> The 2012 Ordinances provided for different methods and requirements to rectify majority manipulation and prejudice, which were based on the nature and purpose of the scheme.<sup>126</sup> Where it is proposed as the means for dealing with a credit or debt issue in a company, the headcount test is retained to recognise the primacy of the broader company in rescue and continuation of operation. In the application for adoption of a scheme plan to restructure a solvent company, the court has discretion to retain the headcount test, and may indeed decline to effect its practice where, on balance, it should be overridden by the prejudice or harm it imposes on dissenters.<sup>127</sup> Some Guidance on the exercise of this discretion is noted in the Hong Kong Company Registry to facilitate to the main purpose of the scheme.<sup>128</sup>

There is no bar to the sanction of a scheme where the court deals with a single member who has the sole legal interest in shares which constitutes that class or indeed the company, per *In Enice Holding Company Limited*<sup>129</sup>, reiterating the UK finding in *TSB Nuclear Energy Investment UK Ltd*,<sup>130</sup> where it was held that: “if there was only one member of the class then one person constituted a valid meeting”.<sup>131</sup>

In the event of a corporate takeover scheme the headcount test is abolished, replaced with a requirement for scheme approval of 75% of those voting members in attendance as long as no

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<sup>125</sup> [2009] 3 HKC 292.

<sup>126</sup> Hong Kong Companies Registry, ‘New Companies Ordinance (Chapter 622)’ 78 <[https://www.cr.gov.hk/en/companies\\_ordinance/docs/NewCO\\_C622\\_HL\\_FullVersion-e.pdf](https://www.cr.gov.hk/en/companies_ordinance/docs/NewCO_C622_HL_FullVersion-e.pdf)> accessed 20 September 2019.

<sup>127</sup> Hong Kong Companies Ordinance 2012, Sections 674(1)(c)(ii) and (1)(d)(ii).

<sup>128</sup> Hong Kong Companies Registry, ‘New Companies Ordinance, Frequently Asked Questions’ <[www.cr.gov.hk/en/companies\\_ordinance/faq\\_headcount-test.htm](http://www.cr.gov.hk/en/companies_ordinance/faq_headcount-test.htm)> accessed 20 September 2019.

<sup>129</sup> *Enice Holding Company Limited* [2018] HKCFI 1736 and see William Wong SC and others, ‘Novel Single-Member Scheme of Arrangement: Re Enice Holding’ (2018) 2 Recent Case Law from the Insolvency, 19 <[https://dvc.hk/E-version\\_Insolvency.pdf](https://dvc.hk/E-version_Insolvency.pdf)> accessed 20 September 2019.

<sup>130</sup> *TSB Nuclear Energy Investment UK Ltd* [2014] EWHC 1272 (Ch).

<sup>131</sup> Insolvency Lawyers Association (n 129).

more than 10% of voters in total vote against the scheme.<sup>132</sup> It is a curious division of roles for a voting procedure perceived as potentially injurious to members, and should it be abolished for one procedure on that basis, it would make sense to do so for all which have the same inherent concerns. Nevertheless, it brings the test for scheme approval by members into harmony with the Hong Kong Code on Takeovers and Mergers,<sup>133</sup> suggesting the official, governmental perception that schemes of arrangement and traditional takeover procedures are similar in nature, justifying the same rules. It also separates Hong Kong from the general member voting practices of its former masters.

Zhen Qu describes the Hong Kong schemes of arrangement as a flexible mechanism allowing companies to engage in restructuring recognised in the global market, although he further asserts a stronger judicial supervision regime will make for greater efficiency, protection and credibility.<sup>134</sup> This somewhat conflicts with the fact that, at the time of this study, there is no adherence to the UNCITRAL Model Law recognition, the statutes appear to be based on the management of insolvency and there is no equivalent of the American Chapters 11 and 15 emphases on the principle of rescue of companies or administrative reorganisation.<sup>135</sup> Zhen nevertheless argues that the approach of the courts has been supportive of a wider application of schemes as a flexible restructuring tool, and advocates for a court controlled moratorium to support the purpose of reorganisation proposals, be it survival and thriving or liquidation, allowing for a more effective better context for evaluation in the period of delay.<sup>136</sup> Statutory provisions should, it is suggested, support the flexibility of approach to corporate needs entertained by the Hong Kong courts.

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<sup>132</sup> Hong Kong Companies Ordinance 2012, Section 674(2).

<sup>133</sup> Securities & Futures Commission, 'The Codes on Takeovers and Mergers and Share Buy-backs' (July 2018) Rule 2, T-2.1 <<https://www.sfc.hk/web/EN/assets/components/codes/files-current/web/codes/the-codes-on-takeovers-and-mergers-and-share-buy-backs/the-codes-on-takeovers-and-mergers-and-share-buy-backs.pdf>> accessed 20 September 2019.

<sup>134</sup> Charles Zhen Qu, 'Towards an Effective Scheme-Based Corporate Recuse System for Hong Kong' (2012) 12 *Journal of Corporate Law Studies* 85, 88.

<sup>135</sup> Tanner DeWitt, 'Overview of Insolvency Law in Hong Kong' (Insolvency Session of the IATA Legal Symposium 2006) <<https://www.tannerdewitt.com/overview-of-insolvency-law-in-hong-kong/>> accessed 20 September 2019.

<sup>136</sup> Zhen Qu (n 134) 85.

### 3.6. Ireland

In 1990, the 'Examinership' model, which leaves the existing management in place, running the company subject to judicial supervision, was introduced by the Companies Amendment Act. It was an early foray into the establishment of the principle of corporate recovery, a formal court intervention into the insolvency process to search for the viability of rescue. A petition capable of being presented by directors, creditors or shareholders, supported by an accountants' report explaining objective grounds for assessing survival prospects.<sup>137</sup> It is essentially an expensive, expert led procedure which constitutes an enquiry rather than a detailed plan for change and evaluation of success.<sup>138</sup> It is this lack of certainty of strategic progress toward viability which distinguishes the procedure from a scheme.

Nevertheless, its "checks and balances ... and authoritative oversight" is designed for the single purpose of company rescue, not, according to McCarthy, the range of service provision of the UK-type scheme of arrangement, used to a 'negligible degree' in Ireland.<sup>139</sup> Unlike the administration procedure it does not assess the potential distribution of corporate assets on insolvency as part of its legislative focus, allowing it to "remain insulated from an analogous rapid emergence of market-driven pre-packaged processes".<sup>140</sup> Essentially, it is a company rescue enquiry, rather than a business salvage, process. The procedure was adopted by Cyprus in 2015, legislating for a moratorium period of four months for companies in financial distress with similar court intervention aimed at formulating proposals for saving the at risk entity.<sup>141</sup>

Although *prima facie* limited in its legislative scope, its focus on the corporate rescue principle embedded in EU law has been broadened by the Irish courts to include aims subsequently

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<sup>137</sup> Harry Fehily, 'The Legal Concept of Examinership' (HOMS 2010) <<https://www.homs.ie/publications/the-legal-concept-of-examinership/>> accessed 20 September 2019.

<sup>138</sup> *ibid*

<sup>139</sup> Jonathan McCarthy, 'Challenges in finding the "right" approach to SME rescue: the example of reforms to the Irish examinership process' (2019) 32(2) *Insolvency Intelligence* 43.

<sup>140</sup> *ibid* 44

<sup>141</sup> Demetris Loizides, 'Cyprus: Amendments To Cypriot Companies Legislation Introduce Examinership' (Mondaq, 24 June 2015) <[accessedhttp://www.mondaq.com/cyprus/x/405708/Corporate+Commercial+Law/Amendments+To+Cypriot+Companies+Legislation+Introduce+Examinership](http://www.mondaq.com/cyprus/x/405708/Corporate+Commercial+Law/Amendments+To+Cypriot+Companies+Legislation+Introduce+Examinership)> accessed 20 September 2019

incorporated in the 2017 Directive, particularly job preservation, community service provision and economic contribution.<sup>142</sup> Much of the final decision-making on the future of the company lies with the court appointed accountant-examiner rather than the existing management, which remains in place. The equivalent of a moratorium prevents third party actions for the distribution of assets, even where that may result in a greater return for creditors than examinership proposals.<sup>143</sup>

It formulates an effective and valuable foundation to consider the implementation of scheme reorganisation options and planning. It contains within its procedure the form of financial examination integral to restructure, albeit via a more expensive process the more direct scheme plan.<sup>144</sup> McCarthy notes that over 400 companies used the examinership procedure between 2007 and 2016, with 56% still trading in 2018.<sup>145</sup> Given the intervening global economic crash, this appears to be a considerable level of success. His statistics do not indicate whether the examinership process itself was the source of company benefit or if its revelations led to identification of other restructure processes which were effected.

The principal domestic statutory framework governing corporate takeovers, restructure and insolvency in Ireland was established in the Irish Takeover Panel Act 1997, its Rules 2013, and the Companies Act 2014 (CA 2014), supplemented by European Regulations on Acquisition Rules and the European Communities (Takeover Bids).<sup>146</sup> As a member of the EU, Ireland shares the comity principles of jurisdiction and recognition of the law and schemes of its fellow members under Regulation (EU) 1215/2012. Specifically, in the arena of insolvency, the global financial crash of 2008 resulted in significant legislative change in the adaptation of schemes of arrangement as Ireland faced the collapse of its financial institutions and infrastructure, to facilitate rescue and survival. It is the CA 2014 which is primarily utilised for corporate restructuring in a context of debt-distress risks, defining the scheme of arrangement as a:

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<sup>142</sup> See *McInerney Homes Ltd* [2011] I.E.S.C. 31

<sup>143</sup> McCarthy (139) 48.

<sup>144</sup> *ibid* 52.

<sup>145</sup> *ibid* 53.

<sup>146</sup> Barry Conway and Aoife Kavanagh, 'A New Departure in Irish Company Law: The Companies Act 2014 - An Overview' (2015) 16 *Business Law International* 135, 136-137.

“... compromise or arrangement proposed between a company and its creditors or its members (or any class of either) that includes a reference to a compromise or arrangement proposed between a company and both its creditors and its members.”<sup>147</sup>

The promotion of the scheme begins with its presentation to members and creditors, usually by the company directors, who will call upon the members and creditors to meet to discuss and express their views by vote.<sup>148</sup> Failure to do will result in a creditor, or a liquidator if the company is financially distressed, applying to the courts to approve such a meeting.<sup>149</sup> The discretion falls on the presiding judge to make orders where he/she considers it just and convenient to do so, for the purpose of directing as to the appropriate scheme meetings to be held.<sup>150</sup>

Powers of direct intervention are granted to the Irish High Court, which appear lacking in the jurisdictions so far considered, which aid judicial oversight of what are essentially corporate proposals to alter obligations, liabilities and rights of international effect. Where there is, for example, a dispute between members and the company, section 443 of the CA 2014 allows the court to stay any other proceedings pending by a director, liquidator or creditor until such time as the members can consider the scheme of arrangement. The integral role of the court in monitoring disclosure is reflected in section 444(4): it is a criminal offence to fail in this duty, although the author has found no instance of this resultant action.

Alternatively, if a scheme of arrangement is being utilised as the basis to effect a company restructure where there is no debt issue, section 447 of the CA 2014 allows the court to move the debts from one company subject to a scheme to another as part of the scheme of arrangement. It affords the courts a discretionary power to allow companies to make additional orders in respect of a corporate restructuring, including the acceptance of the continuance of liabilities of one company within the new reformed entity which may to some extent ameliorate the concerns of an affected dissenting minority.<sup>151</sup>

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<sup>147</sup> Companies Act 2014, Section 441.

<sup>148</sup> *ibid* Section 442(1).

<sup>149</sup> *ibid* Section 442(3) and (4).

<sup>150</sup> *ibid* Section 442(5).

<sup>151</sup> Adrian Benson and Lorcan Tiernan, ‘Corporate Insolvency in Ireland’ (Dillon Eustace 2009) 4-6.

A 'special majority' of 75% company members by value is required to approve the scheme, per section 445, with a notice placed in two national newspapers of the restructure.<sup>152</sup> The process of court approval and sanction is similar to the approach in the UK, a determination that the process has been complied with. The approved scheme is then centrally registered within 21 days, per section 446(1) and attached to the company's constitution.

In common with the schemes of arrangement review in this chapter of the study, Ireland legislates for court monitoring, which is considered essential to the global acceptance of the new corporate entity that emerges. In *Ballantyne Plc*<sup>153</sup>, an Irish company which provided bespoke insurance services for American corporations entered into an agreement with a similar but bigger US company, transferring its operation by means of restructure followed by voluntary liquidation and then merger. The 'lock up' agreement on voting rights obliged the main shareholder class to support the agreement. Indeed, prior to the implementation of the process, assurances were sought from the US courts that the dissolution and merger would be recognised. It facilitates a rationalisation of business arrangements, interlinking connected interests and easing satisfaction of broader company needs, similar to the takeover and merger of Flybe in the UK, which enhanced the organisation of Virgin and Stobarts' aviation commercial needs, although Flybe itself faced involuntary liquidation.<sup>154</sup>

The CA 2014 empowers the courts to deal with concerns of minority members who do not support the scheme, enabling judges to require variation of a scheme before approval to accommodate contentious issues.<sup>155</sup> This gives the court a more proactive role in the reconstruction process.

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<sup>152</sup> Justin McKenna and David Mangan, 'Ireland' (2012) 1 The European Lawyer Reference Series: Mergers & Acquisitions 1 <<https://www.mhc.ie/uploads/the-european-lawyer-manda-2012.pdf>> accessed 20 September 2019.

<sup>153</sup> [2019] IEHC 407. Also, see Lawton and Wolf (n 103).

<sup>154</sup> See Chapter II, 2.2.3.

<sup>155</sup> David Baxter, 'Ireland' in T Vickers (ed), *Corporate Restructuring 2016* (The Strategic Review 2017) 54-55.



In the Brexit context, the Irish Bar reports “unique and difficult challenges for Ireland and Irish business”.<sup>156</sup> Having said this, it may also provide considerable opportunities as the UK leaves the regulatory standards of the EU as Ireland will then be the EU’s largest common law jurisdiction.<sup>157</sup> However, Breslin argues that Ireland is not sufficiently prepared to profit from the exit of the UK from the EU and considers the EU Directive to be insufficiently comprehensive to ease the foreign court’s decision on recognition. Ireland will also continue to be a less suitable forum for international commercial disputes resolution until it adopts the UNCITRAL Model Law on Cross-Border Insolvency.<sup>158</sup>

The Irish Court of Appeal in *Official Assignee v Dunne*<sup>159</sup> noted the respondent therein fled Ireland, hid assets and filed for bankruptcy in America. Creditors in Ireland filed parallel proceedings to gain access to the corporate assets but considerable quandaries arose in the binding of American creditors to Irish orders and *vice versa*.<sup>160</sup> Murphy et al note that its domestic legislation contains no mechanism for the recognition of restructuring or insolvency processes.<sup>161</sup> Nevertheless, the Irish courts will apply the comity principle insofar as recognition is concerned, but cannot, without legislation, aid enforcement of non-EU orders.<sup>162</sup> It is a worthy and profitable investigation to be undertaken by the *Dáil Éireann* to make the law more attractive to international companies after the departure of the UK from the single EU market.

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<sup>156</sup> Bar of Ireland and Law Society of Ireland, ‘Promoting Ireland as a Leading Centre Globally for International Legal Services’ (8 May 2018) <<https://www.lawlibrary.ie/media/lawlibrary/media/Secure/Promoting-Ireland-as-a-leading-centre-globally-for-international-legal-services.pdf>> accessed 20 September 2019.

<sup>157</sup> *ibid* 6.

<sup>158</sup> John Breslin, ‘Ireland: Gaps in International Insolvency Law’ (Mondaq 5 April 2018) <<http://www.mondaq.com/ireland/x/689326/Insolvency+Bankruptcy/Gaps+In+International+Insolvency+Law>> accessed 20 September 2019.

<sup>159</sup> *Official Assignee v Dunne* [2018] IECA 7.

<sup>160</sup> Breslin (n 158).

<sup>161</sup> Julie Murphy O’Connor, Brendan Colgan and Tony O’Grady, ‘Cross-border Insolvency in Ireland’ (Matheson November 2018) <<https://www.lexology.com/library/detail.aspx?g=69622ad7-149f-4373-b270-9783d2383617>> accessed 20 September 2019.

<sup>162</sup> *ibid*.

### 3.7. New Zealand

New Zealand adopted the statutory scheme of arrangement in the Companies Act 1993. The Act added to, but effectively consolidated, various legislative measures regulating corporate functions, procedures and actions where restructuring was primarily based on takeover and merger law, with the role of the courts largely confined to formal approval based on an agreement with little evaluation of its terms.<sup>163</sup> The Takeover Panel handled takeovers while mergers and acquisitions were dealt with by contractual methods agreed upon for strategic reasons, often in a context of hostile negotiation and resistance.<sup>164</sup>

Corporate jurisdiction requirements under the CA 1993 necessitate that foreign companies be carrying on business in New Zealand by establishing or using a share transfer office or administering, managing, or owning property, per section 334. Other indicative factors of such activity include involvement in legal proceedings, holding meetings of directors or shareholders or conducting other internal affairs, maintaining a bank account, incurring debts or creating charges. In administering schemes, the court will consider jurisdiction based on the individual facts of the relationship with the territory.<sup>165</sup>

New Zealand is a signatory of the UNCITRAL Model Law on Cross Border Insolvency, enacted into domestic legislation by the Insolvency (Cross-border) Act 2006. It will recognise and aid enforcement of foreign schemes of arrangement insofar as they affect interests on its territory, subject to a national policy compliance assessment by the Solicitor-General.<sup>166</sup> Further, under section 342 of the CA 1993 foreign corporations registered outside the jurisdiction may apply for, or be put into liquidation, under New Zealand law by the Court, and overseen by an

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<sup>163</sup> Rt Hon Peter Blanchard, 'Approaches to Business Rehabilitation' (2005) 13 Waikato Law Review 46.

<sup>164</sup> John Cottle and Gill James, *Morison's Company Law in New Zealand* (Butterworths Law 2014) 48.

<sup>165</sup> Michael Chin, "'Carrying on Business" in New Zealand ... A New Legal Test for Internet Trading' (2003) 5(1) University of Auckland Business Review 1, 3-4.

<sup>166</sup> Scott Abel, 'New Zealand: Restructuring & Insolvency' (The Legal 500 and The In-House Lawyer Comparative Legal Guide 16 May 2018) 17 <<https://www.buddlefindlay.com/media/2282/the-legal-500-2nd-edition-restructuring-insolvency-comparative-guide.pdf>> accessed 20 September 2019.

administrator to protect foreign and domestic interests and assets.<sup>167</sup> It is an attractive jurisdiction for foreign creditors.

Schemes of arrangement are addressed by Parts 15 to 17 of the CA 1993.<sup>168</sup> Part 15 provides for a court-mandated procedure that allows shareholders and creditors as well as companies to advance a scheme of arrangement to facilitate a corporate restructuring that is “binding on the company and on such other persons or classes of persons as the court may specify”.<sup>169</sup> This gives the court a broad range of discretion to grant legal effect to any proposal advanced by a company in relation to its reorganisation process, although it must be satisfied that the scheme does not adversely affect shareholders of the company and there is no objection from the Competition Panel.<sup>170</sup> This is particularly pertinent where the proposed scheme of arrangement merger or takeover might impact competition within New Zealand.

The imposition of a moratorium aids the court supervised negotiations with creditors in the event of potential insolvency.<sup>171</sup> This is indicative of the value of a ‘breathing-space’ necessary to effect possible rescue from financial distress. It is not available in the UK scheme of arrangement procedure under Part 26 of the CA 2006.<sup>172</sup> The Insolvency Commission’s 2016 Consultation Paper supports the introduction of a moratorium to facilitate scheme negotiations where the company can be rescued and can demonstrate that it has sufficient funds to continue in business during the period and meet liabilities as they fall due.<sup>173</sup> The process of giving effect to a reorganisation of obligations, liabilities and corporate restructure proposal by the company officers, outlined in section 236 of the CA 1993, reflects broadly those of the UK.

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<sup>167</sup> *ibid.*

<sup>168</sup> *ibid.*

<sup>169</sup> Companies Act 1993, Section 236.

<sup>170</sup> *ibid* Section 236A.

<sup>171</sup> Abel (n 166) 7.

<sup>172</sup> Companies House, *Guidance: Liquidation and Insolvency* (8 August 2018)

<<https://www.gov.uk/government/publications/liquidation-and-insolvency/liquidation-and-insolvency>> accessed 20 September 2019.

<sup>173</sup> Jennifer Payne, ‘The Government Announces Radical Changes to the UK Debt Restructuring Regime’ (Oxford Business Law Blog 11 September 2018) <<https://www.law.ox.ac.uk/business-law-blog/blog/2018/09/government-announces-radical-changes-uk-debt-restructuring-regime>> accessed 20 September 2019.

Section 236A of the CA 1993 requires that those interested designated class divisions of members and creditors affected by a proposed scheme must have the opportunity to vote in an informed manner. Schedule 10 of the CA 1993 provides the basis upon which a company should divide their classes of voter, and this is in a manner similar to the class designations utilised in the UK procedure based on assessments of comparative similarity of share rights. Determining voter class allocation must be just and fair, and not manipulated to limit the influence of dissenters, as per *New Zealand Oil & Gas Limited*.<sup>174</sup> Failure to meet such obligations for voter protection will likely mean rejection a proposed scheme on procedural grounds.<sup>175</sup> The threshold required to approve a scheme is, as is common in other jurisdictions, a 75% shareholder majority in each class, with 50% of the total voting rights available.<sup>176</sup> Procedural compliance and no domestic competition issues arising from a merger or takeover scheme will normally result in the court exercising its approval discretion.

A 2017 report on New Zealand notes that its High Court follows a broad approach as to the types of transactions that can be implemented in this way. It has the power to make orders that appear to override procedural or substantive obligations set out in the CA 1993 or a company's constitution.<sup>177</sup> By way of example, the use of schemes of arrangement to execute a corporate takeover was initially a source of controversy in New Zealand corporate and legal communities, lacking the more intensive supervisory oversight of the Takeover Panel.<sup>178</sup> It was considered a 'sneaky loophole', given that it required a lower voting level than the 90% required of the law on mergers and takeovers.<sup>179</sup> The takeover procedure was strict in application and supervision,

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<sup>174</sup> [2015] NZHC 39.

<sup>175</sup> *Hellenic & General Trust Ltd* [1976] 1 WLR 123. More recently, see: *Advicewise People Ltd v Trends Publishing International Ltd* [2016] NZHC 2119, *Aston Resources Ltd* [2012] FCA 229 and *Cashcard Australia Limited* (2004) 48 ACSR 738.

<sup>176</sup> Andrew Matthews, 'More Schemes of Arrangement Tipped for Takeovers' (New Zealand Law Society 28 February 2017) <<https://www.lawsociety.org.nz/news-and-communications/latest-news/news/more-schemes-of-arrangement-tipped-for-takeovers>> accessed 20 September 2019.

<sup>177</sup> Russell McVeagh, 'Schemes of Arrangement in New Zealand' (Russell McVeagh August 2017) <<https://www.russellmcveagh.com/getattachment/Insights/August-2017/Schemes-of-arrangement-update/Schemes-of-arrangement-guide-1.pdf?lang=en-NZ>> accessed 20 September 2019.

<sup>178</sup> Clune (n 71).

<sup>179</sup> Andrew Matthews (n 176).

particularly Part 13 Memorandum of the CA 1993 that limits share purchases on the stock market. The scheme, as a process based on negotiation, avoids this restriction.

The Transfer Code 2001 recognises the integration of takeover procedures into the scope of the scheme.<sup>180</sup> The Companies Amendment Act 2014 effectively approves the scheme as a legitimate takeover method.<sup>181</sup> In 2006, the high-value New Zealand public trading company, Contact Energy Limited, announced its intention to merge with the Australian company Origin Energy Limited via the scheme process.<sup>182</sup> The controversy was predicated on the dilution of national interest being undertaken by a method which required considerably less scrutiny than a merger overseen by the Takeover Panel.<sup>183</sup> It was a tactical choice based on individual business assessment or the relative ease of the comparative practices. Waste Management NZ Limited and Australia's Transpacific Industries Group Ltd followed that example shortly afterwards, announcing merger under Part 13 CA 1993, again facing criticism of avoidance of Takeover Panel input and supervision.<sup>184</sup> They were legitimate procedures, no doubt tactically chosen, but nevertheless legal.<sup>185</sup>

The role of the Takeover Panel is arguably somewhat obsolete, the 2001 Code restricting its powers to ensuring that voting measures were correctly applied and shareholders properly notified.<sup>186</sup> It has no application to schemes of arrangement which now account for half of the merger procedures.<sup>187</sup> Section 239ADO(1) of the CA 1993 allows for an exceptionally wide use of schemes of arrangement, enabling the court to make an order using its versatile power to

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<sup>180</sup> Clune (n 71) 96-97.

<sup>181</sup> Chapman Tripp, 'Scheming for a Takeover?' (Chapman Tripp 15 February 2016)

<<https://www.chapmantripp.com/publications/2016-scheming-a-takeover>> accessed 20 September 2019.

<sup>182</sup> Rachel Pannett, 'Contact Energy to Merge with Origin' (New Zealand Herald 20 February 2006)

<[https://www.nzherald.co.nz/business/news/article.cfm?c\\_id=3&objectid=10369229](https://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10369229)> accessed 20 September 2019.

<sup>183</sup> Clune (n 71).

<sup>184</sup> *ibid.*

<sup>185</sup> *ibid* 92-93.

<sup>186</sup> *ibid* 95.

<sup>187</sup> Bell Gully, 'The Big Picture: Takeovers Update' (March 2018)

<<https://www.bellgully.com/Shared%20Documents/The%20Big%20Picture%20Takeovers%20Update.pdf>> accessed 20 September 2019.

approve any arrangement, amalgamation or compromise to effect any corporate transaction.<sup>188</sup> This considerable judicial discretion on sanctioning a proposed scheme is somewhat broader in scope and practice than the UK source and its near neighbour Australia, an attractive jurisdiction in the Southern hemisphere for corporate reorganisation with international recognition.

### **3.8. Singapore**

Schemes of arrangement have been a popular method of flexible corporate restructure since the 1990s in Singapore. They have long been used as a tool for restructuring large and medium-sized companies as an alternative to more complex takeover and merger legislative procedure and supervision.<sup>189</sup> Schemes are particularly valuable in dealing with corporate risk-laden debt problems, where the courts were often willing to grant companies considerable flexibility in negotiating a settlement not otherwise provided for in alternative legislation.<sup>190</sup> The increasing global demand for corporate reorganisation has resulted in states having to review how their national law to provide legal services which suit the needs of the international market.<sup>191</sup>

It is this process of review and change which Singapore has embraced to attract business and enhance its reputation as an international centre of finance. It has developed a broad legislative policy to fulfil business protection and restructure needs, with jurisdictional requirements similar to those of the UK and including the interpretive breadth of interpretive discretion. This section will consider how that policy development has progressed in practice.

#### **3.8.1. The 2006 Schemes of Arrangement**

Chan notes that in Singapore schemes of arrangement emerged as a popular choice for those seeking to restructure company operations provided for in section 210 of the Singapore

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<sup>188</sup> CA 1993 (n 169) Section 239ADY(1).

<sup>189</sup> Sarah Paterson, 'Rethinking Corporate Bankruptcy Theory in the Twenty-First Century' (2016) 36 OJLS 697, 699-700.

<sup>190</sup> *Hitachi Plant Engineering & Construction Co Ltd v Eltraco International Pte Ltd* [2003] SGCA 38.

<sup>191</sup> Gerard McCormack and Wai Yee Wan, 'Transplanting Chapter 11 of the US Bankruptcy Code into Singapore's Restructuring and Insolvency Laws: Opportunities and Challenges' (2018) 19 Journal of Corporate Law Studies 1.

Companies Act (SCA).<sup>192</sup> This process prescribed by section 210(1) is shared with all of the jurisdictions considered herein, the proposal for restructure presented to the court, serving as a prelude to a meeting of members or creditors with voting rights to discuss, question and vote on the scheme.<sup>193</sup> Members must be appropriately classified on the basis of similarity of commonality of interests and rights.<sup>194</sup> An affirmative vote to approve the restructure scheme will result in further court hearing where it will be sanctioned and the order lodged with the Accounting and Corporate Regulatory Authority in Singapore.<sup>195</sup> This is a broad, simple summary of the process, notably similar to that of the UK.

Following the UK approach, notice to affected members must describe the impact of the scheme, provide all relevant information, financial data, party interests, particularly of the management and any other information the court considers appropriate. In *Dorman, Long and Co*<sup>196</sup> and *Wah Yuen Engineering Pte Ltd v Singapore Cables Manufacturers Pte Ltd*,<sup>197</sup> the courts refused to sanction a scheme under section 212 powers because the court determined members had not been sufficiently informed about its impact on them and others; rectification was demanded before the restructure proposal would be permitted to proceed.

Elias asserts that a scheme must not carry within its plan the potential for change post-court approval, save where provided for in the event of pre-defined eventualities.<sup>198</sup> Simply put, the company should not say one thing then do another. The courts in Singapore play a similar role to their UK counterparts, with judges essentially focusing on procedural matters and whether the proposed scheme represents a fair and reasonable deal for company members.<sup>199</sup> In *The*

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<sup>192</sup> Tracey Evans Chan, 'Schemes of Arrangement as a Corporate Rescue Mechanism' (2009) 18 International Insolvency Review 37, 40-41.

<sup>193</sup> Singapore Companies Act, Section 210(3).

<sup>194</sup> *Wah Yuen Engineering Pte Ltd v Singapore Cables Manufacturers Pte Ltd* [2003] 3 SLR 629, para 11.

<sup>195</sup> SCA 2006 (n 193), Section 210(3) and Section 210(4).

<sup>196</sup> [1934] Ch 635.

<sup>197</sup> *Wah Yuen* (n 194).

<sup>198</sup> Harry Elias, 'Whose Scheme Is It Anyway? The Law on Schemes of Arrangement in Singapore after SK Engineering Construction Co Ltd v Conchubar Aromatics Ltd' (Eversheds Harry Elias 5 December 2017) <<https://www.eversheds-harryelias.com/content/whose-scheme-it-anyway>> accessed 20 September 2019.

<sup>199</sup> *Daewoo Singapore Pte Ltd v CEL Tractors Pte Ltd* [2001] 4 SLR 35, 51.

*Royal Bank of Scotland NV v TT International Ltd*<sup>200</sup> the court was dissatisfied with the failure to disclose a success fee due to advisors on completion in a review approach to the approval process which is adopted in English jurisprudence.<sup>201</sup> The discretion applies however, as in the English courts, to determine that non-disclosure would not have affected voter decision. Given that the scheme was in operation for two years, it was sanctioned.<sup>202</sup>

### 3.8.2. The Companies Amendment Act 2017

Singapore has reformed its legislation on schemes to enhance its use and value to the market and to attract international business. Reforms were enacted by the Companies Amendment Act 2017 (CAA 2017).<sup>203</sup> In terms of jurisdiction, it requires the company to have a 'substantial connection' to Singapore of a company capable of being wound up by its courts. This appears more onerous than 'sufficient' and arguably more restrictive in interpretation.<sup>204</sup> The company must have Singapore as its main centre of business or have substantial assets in the country, although it would be substantial enough to meet the requirements where loans are transacted or it has accepted jurisdiction in a legal dispute. As such, it accords similar access to foreign companies as its near neighbour New Zealand. It is likely to apply discretion in the manner of the UK courts.

The Ministry of Finance Reports in 2011 and 2016, in identifying core concerns with the functioning of the scheme, led to the 2017 amendments to introduce principles inherent in Chapter 11 of the US Bankruptcy Code to enhance protection of the debtor company. The American case of *Canadian Pacific v Irving* stated that the Chapter 11 objective is to protect the company from creditors whilst it reorganises in order to provide said creditors with "going-

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<sup>200</sup> [2012] SGCA 9.

<sup>201</sup> Chi-Ling Seah, 'The Re Tea Corporation Principle and Junior Creditors' Rights to Participate in a Scheme of Arrangement – A View from Singapore' (2011) *International Insolvency Review* 161, 166-167.

<sup>202</sup> Ronald Wong, 'Case Update: The Royal Bank of Scotland NV v TT International Ltd [2012] 4 SLR 1182; [2012] SGCA 53 – Disclosure of Professional Fee Arrangements to Scheme Creditors and the Court' (1 December 2012) <<http://www.ronaldjwong.com/2012/12/01/rbs-tt-international-2012sgca53/>> accessed 20 September 2019.

<sup>203</sup> Companies (Amendment) Act 2017.

<sup>204</sup> Paul Apáthy and Emmanuel Chua, 'Singapore's New "Supercharged" Scheme of Arrangement' (2017) 5 *Butterworths Journal of International Banking and Financial Law* 282.



concern value rather than a more meagre satisfaction of outstanding debts through liquidation”.<sup>205</sup> The amendments are reviewed in the context of their 2006 legislation references.

Voting requirements and classification of interests is contentious, it seems, across all jurisdictions. Section 210(1) of the SCA lacked clarity in this regard, broadly stating a scheme could be proposed “between a company and its creditors or any class of them or between the company and its members or any class of them”. It fails to specify which voters could be included, how they should be classified or, for example, whether holders of options were entitled to participate.<sup>206</sup> The courts nevertheless have to decide what interests constitute legal rights and which do not carry such entitlements, for example, some bond holders or trustees whose interests are still market tradable. This has arguably become less significant with the revised emphasis on debtor company protection and the facilitation of restructure.

As an example of the balance shift in legislative emphasis under the SCA, section 227B(5) indicates that “the general secured creditor bears the burden of establishing that it would be caused disproportionately greater prejudice by the making of a judicial management order than unsecured creditors would be caused by its refusal”.<sup>207</sup> Nevertheless, section 211(H)(3) of the CAA 2017 is less legally brutal than the Chapter 11 cram-down effect on dissenting creditors or classes, requiring the court to be “satisfied that the scheme is ‘fair and equitable’ to dissenting creditors and does not ‘discriminate unfairly’ between two or more classes of creditors”.<sup>208</sup>

The second concern related to the formulation and construction of the headcount test, considered worthy of review in jurisdictions such as Australia and Hong Kong for its disproportionate effect on schemes, allowing minority interests greater influence than the

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<sup>205</sup> *Canadian Pacific Forest Products Ltd v JD Irving Ltd* (1995) 66 F 3d 1436, 1442.

<sup>206</sup> Ministry of Finance, *Report of the Steering Committee for the Review of the Companies Act: Consultation Paper* (Ministry of Finance Singapore 2011) para 143-149.

<sup>207</sup> McCormack and Wan (n 191) 13.

<sup>208</sup> *ibid* 19.

value of their shareholdings would justify.<sup>209</sup> Interestingly, it was decided to reject the idea of completely abolishing the headcount test on the grounds that this had been retained in British legislation despite calls for its abolition.<sup>210</sup> A preference for the Australian approach was expressed, which retains the headcount test but gives discretion to the judges to vary the test in terms of how it is applied in individual cases.<sup>211</sup> Section 135 of the Companies (Amendment) Act 2014 represents an amendment of section 210(3AB)(a) and (b) of the SCA and allows judges the discretion to amend the headcount test requirement. This permits greater flexibility to the application of the established principle, the discretion to be exercised on consideration of commercial need whilst denying the opportunity of manipulative self-interest.<sup>212</sup> It is a somewhat adapted principle, established practice performed with discretion and flexibility,<sup>213</sup> arguably a legal oxymoron.

Further reform was undertaken for a moratorium on actions.<sup>214</sup> The Singapore scheme allows a debtor who has proposed a scheme to make an application to the courts to obtain ‘breathing space’ on any pending action, including staying international claims, until the proposed scheme has been voted upon by members.<sup>215</sup> This has been provided for in the new reforms under section 211B of the CAA 2017 with an automatic 30 day interim stay on filing claims, including the enforcement of security and the forfeiture of leases.<sup>216</sup> This is a reflection of the Chapter 11 protection to allow restructure. Specific application under the moratorium must be made to the court to hold back claims arising in other jurisdictions. Nevertheless, it is possible to apply for a moratorium when a scheme is to be proposed rather than awaiting its preparation, which is a

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<sup>209</sup> Renee Adams and Daniel Ferreira, ‘One Share-One Vote: The Empirical Evidence’ (2008) 12 *Review of Finance* (2008) 51, 52.

<sup>210</sup> Ministry of Finance (n 206) paras 150-151.

<sup>211</sup> *ibid.*

<sup>212</sup> *ibid* 3-35 to 3-38.

<sup>213</sup> Payne (n 26) 64-66.

<sup>214</sup> SCA (n 193), Section 210(10).

<sup>215</sup> Jeffrey Tanner, ‘Singapore “Supercharged” Scheme of Arrangement’ (Global Transport Finance October-November 2017) 53 <[https://www.shlegal.com/docs/default-source/news-insights-documents/bd355-singapore-story.pdf?sfvrsn=66b5175b\\_0](https://www.shlegal.com/docs/default-source/news-insights-documents/bd355-singapore-story.pdf?sfvrsn=66b5175b_0)> accessed 20 September 2019.

<sup>216</sup> McCormack and Wan (n 191) 14.

time-consuming professional drafting process that leaves companies vulnerable to pending actions in the meantime.<sup>217</sup>

The government Committee to Strengthen Singapore as an International Debt Restructuring Centre aims to extend the international influence of, and business attraction to, the island for their corporate organisational needs.<sup>218</sup> Singapore set about implementing improvements, acknowledging that reform was needed in order to incorporate approaches from other jurisdictions, including the UK and US to dealing with corporate financial distress. Specific issues absent from the SCA have now been amended in the CAA 2017. Recognition and enforcement of scheme restructures, for example, are now provided for in Section 211A-J of the SCA (as amended in the CAA 2017) that allow for their enforcement in Singapore. The policy of regular review and reform arguably reflects the considerable governmental and corporate value placed on the scheme as a corporate tool. This is a flexible cure for the ills of a financially distressed company or those that desire structural and market adaptation.

Section 210(4) of the SCA has provided the court with the power to sanction a scheme that has been approved by its members, but “subject to such alterations or conditions as it thinks just”. There is no equivalent formal provision within UK legislation to facilitate such a level of intervention rather than supervision. The level of discretion affords the court more influence in ensuring the fairness of the statutory exercise. It does not make approval less certain but adds to the commercial and reputational benefits of avoiding many of the legal conflicts on rights surrounding the other corporate restructuring requirements.<sup>219</sup>

### **3.9. South Africa**

Internal microeconomic problems and the volatility of the rand, exacerbated by global financial instability, militate against the attractiveness of South Africa to foreign companies in terms of

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<sup>217</sup> For example, See *Kuala Lumpur Industries Bhd* [1990] 2 MLJ 180 (Malaysian case).

<sup>218</sup> Committee to Strengthen Singapore as an International Centre for Debt Restructuring, ‘Report’ (20 April 2016) <<https://www.mlaw.gov.sg/content/dam/minlaw/corp/News/Final%20DR%20Report.pdf>> accessed 20 September 2019.

<sup>219</sup> Federico Mucciarelli, ‘Brexit and its Impact on Insolvency Forum and Law Shopping’ (2017) *South Square Digest* 24, 24-25.

the choices made available to companies seeking restructure jurisdictions apposite to their particular needs.<sup>220</sup> Nevertheless, South Africa was an early signatory to the UNCITRAL Model Law on Cross-Border Insolvency, which was enacted into the Cross-Border Insolvency Act 2000 (CBIA 2000). It will therefore recognise and assist in the enforcement of foreign scheme of arrangement orders. Thereunder, foreign creditors are accorded the same rights as those in the jurisdiction and indeed in South African courts, with foreign interest holders, such as trustees, being able to participate in the proceedings.<sup>221</sup>

Schemes of arrangement in South Africa follow a similar structure to the jurisdictions considered in this chapter as they are used as a mechanism to deal with corporate insolvencies and corporate restructuring. Legislated for under the Companies Act 2008 (CA 2008), its provisions have been supplemented and indeed altered by the Companies Regulations 2011.<sup>222</sup> Prior to this enactment there existed a rather complex, confusing range of methods under law to deal with financial distress, threat of insolvency or rationalising restructure of companies. This arguably stemmed from a lack of clarity in key legislative definitions of takeovers, scheme of arrangement, corporate merger and acquisition, amongst others. In terms of jurisdiction of South African legislation, be it for enforcement or the entitlement to use its provisions to undertake reorganisation, companies will find similar requirements under section 23 to all others examined herein.<sup>223</sup> These include registration and carrying on a business or non-profit activities.

Section 311 of the Companies Act 1973 (CA 1973) provided for schemes of arrangement, but failed to define the term, thus giving rise to problems of interpretation, purpose and limitation.<sup>224</sup> The most common mechanisms of corporate change and adaptation were the

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<sup>220</sup> Riza Moosa, 'The Strategic View - Corporate Restructuring 2016 South Africa' (Norton Rose Fulbright April 2016) <<http://www.strategicview.co.uk/strategic-view/corporate-restructuring/the-strategic-view-corporate-restructuring-2016/south-africa>> accessed 20 September 2019.

<sup>221</sup> *ibid.*

<sup>222</sup> Philip Meskin, *Insolvency Law and its Operation in Winding-up* (Lexis 2012) 414-416.

<sup>223</sup> Paula Kennedy Smith, 'The New Companies Act 2008 and Foreign or External Companies' (Dingley Marshall 17 August 2011) <<https://www.dingleymarshall.co.za/the-new-companies-act-2008-and-foreign-or-external-companies/>> accessed 20 September 2019.

<sup>224</sup> Michael D Emmett and Trafford B Barlow, *Principles of South African Company Law* (Juta and Co 2016) 6061.

scheme of arrangement and what was described as the compromise. There was no need to involve an administrator or court to reach the agreement, but once entered into with creditors, a number of applications had to be made to court, which resulted in the process becoming expensive and cumbersome.<sup>225</sup>

The court does not have a role in actually approving a compromise with creditors, but 75% of shareholders and meeting participants must be in favour of the agreement, thus giving shareholders considerable influence over whether a company is rescued or dissolved. This process remains a choice under section 155 of the CA 2008, but Klopper and Bradstreet suggest that a company in financial distress may instead opt to make use of business rescue under the scheme of arrangement under Chapter 6 of the CA 2008, considerably more flexible than the alternative methods of rescue and reorganisation, and indeed merger, acquisition and insolvency.

### 3.9.1. The 'Old' Schemes of Arrangement

Under the 1973 legislative scheme of arrangement, the influence of the UK process was obvious, even though South Africa was a considerably less economically developed nation in a state of some considerable internal turmoil and international opprobrium. It is also of note that constituent states of the nation had their own procedures for dealing with insolvency in their territorial jurisdictions, with a unification of the law not introduced until the end of the economically insular apartheid regime. Nevertheless, the law of the likes of Cape Colony and Natal were broadly similar, deriving their characteristics from the UK legislation of the early 1900s.<sup>226</sup>

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<sup>225</sup> Hans Klopper and Richard S Bradstreet, 'Does the S 155 Compromise Further the Objectives of Business Rescue?' (Independent Advisory Newsletter January 2015) <[https://www.insol.org/emailer/Mar\\_2015\\_downloads/Independent%20Advisory\\_Does%20the%20S%20155%20Compromise%20Further%20the%20%20Objectives%20of%20Business%20Rescue.pdf](https://www.insol.org/emailer/Mar_2015_downloads/Independent%20Advisory_Does%20the%20S%20155%20Compromise%20Further%20the%20%20Objectives%20of%20Business%20Rescue.pdf)> accessed 20 September 2019.

<sup>226</sup> David Alan Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa' (University of Pretoria 2002) Ch 5 <<https://repository.up.ac.za/bitstream/handle/2263/29560/Complete.pdf?sequence=11>> accessed 20 September 2019.

Briefly, a management reorganisation proposed by a scheme, a merger-takeover plan and, as per section 311(8),

“a reorganisation of the share capital of the company by the consolidation of shares of different classes or by the division of shares into shares of different classes or by both these methods, would be presented to the court. Thereafter, (i) application for leave to convene a shareholder meeting to consider the same would be made, whereupon (ii) the company would distribute comprehensive information and details of impact of the restructure and (iii) call a shareholders’ meeting to vote on the plan.”<sup>227</sup>

In the case of a merger or takeover, this procedure would be undertaken by the target company. The vote required a 75% majority of those shareholders attending to proceed to seek approval of the court and registration with the Register of Companies.<sup>228</sup>

Justice Van der Linde in *Ex parte Federale Nywerhede Bpk*<sup>229</sup> addressed the particular issue of prejudice to minority interests in a takeover scheme where members are to lose significant rights under section 311 of the CA 1973. In the management plan for a near insolvent company, shareholders were expected to sacrifice their entitlements in law for payment based on value at the time of acquisition by the proposed new owner, which was substantially lower than the fair market price. The tactical choice of the flexible scheme of arrangement method was to avoid the restrictions of the takeover law in the face of dissent and to utilise the flexibility of the scheme of arrangement.<sup>230</sup> It prejudiced minority shareholder interests but was considered more likely to be a successful sale of the company than the more rigorous strictures of section 440 of the CA 1973.

The path to reform and consideration of the scheme as more than simply an alternative way of managing potential insolvency was paved by section 311(8) of the CA 1973. This provided for reorganising the share capital of the company. Shares could be divided into different classes, or

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<sup>227</sup> Kevin Markman, ‘Schemes of Arrangement under the New Companies Act: Better or Worse?’ (ENS Law Insight 27 July 2010) <<https://www.ensafrica.com/news/schemes-of-arrangement-under-the-new-companies-act-better-or-worse?Id=380&STitle=corporate%20commercial%20ENSight>> accessed 20 September 2019.

<sup>228</sup> David Burdette, ‘Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 1)’ (2004) 16 South African Mercantile Law Journal 241, 241.

<sup>229</sup> [1975] 1 SA 826.

<sup>230</sup> Piet A Delpont and others, *Henochsberg on the Companies Act* (Enlightened Publications 2009) 167.

consolidated within the parameters of different classes, yet yield the same outcome for the reorganisation of the share capital structure of the entity, per *Ex parte JR Starck & Co (Pty) Ltd*.<sup>231</sup> This included capital reduction, company resolutions for acquisition and buy-back and even a consequent extinguishing of shares. On the latter action plan, the court in *Starck* affirmed that should the legal and corporate Articles requirements for share reduction be met, which would effectively extinguish some member interests rather than their acquisition, the proposal would be within the law. This is indeed a swingeing authority given to company management, and *prima facie* of potential serious prejudice to minority shareholder interests, although this did require a review and court approval at a final hearing.

Court approval of a scheme of arrangement may be required where (i) a dissenting shareholder successfully seeks the leave of the court to compel court review and a decision on the probity of the arrangement or (ii) more than 15% of the shareholders in attendance at the shareholder's meeting voted against the proposal, in which case it is an automatic right.<sup>232</sup> In respect of an individual application, judicial discretion is exercised on the basis of the applicant shareholder's good faith and their capacity to sustain proceedings and if the contention of malfeasance or misconduct in the passage of the scheme is proven.

The court could only set aside a proposed scheme of arrangement if it concludes that it is clearly unfair to a class of shareholder or that the voting procedure was such that there were conflicts of interest, insufficient disclosure or there was some failure in the scheme of arrangement procedure that conflicted with the company's memorandum of incorporation or there was some other material procedural irregularity.<sup>233</sup> Before a scheme could be accepted, the court has to be satisfied there was an element of 'give and take' rather than simple overriding of minority interests for a perceived corporate good; this assessment role is not accorded to the UK judiciary when there is procedural compliance. This essentially UK model

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<sup>231</sup> [1983] 3 SA 41 (W).

<sup>232</sup> Hermie Coetzee, 'Is the Unequal Treatment of Debtors in Natural Person Insolvency Law Justifiable? A South African Exposition' (2016) 25(1) International Insolvency Review 36, 37.

<sup>233</sup> Andre Boraine and Jani van Wyk, 'Various Aspects to Consider with Regard to Special Insolvency Rules for Small and Medium-Sized Enterprises in South Africa' (2016) 25(1) International Insolvency Review 3, 8-9.

was revised, reformed and modernised with the enactment of the CA 2008 to fit the new South African national and corporate context.

### 3.9.2. *The 'Current' Schemes of Arrangement*

Moosa comments that business rescue is the driver behind South African corporate restructure activity, a process much like English law administration which can be set in motion without court intervention.<sup>234</sup> Creditors also remain prepared to negotiate informally, generally seeking resolution of problems as a precursor to a formal application for a scheme of arrangement, especially in the context of potential corporate demise.<sup>235</sup> However, success rates of restructure in the South African economic context are low due to the endemic political instability of the region.<sup>236</sup>

In South Africa, corporate rescue from insolvency can be achieved by allowing for a compromise to be reached between the company and its creditors under the supervision of an insolvency practitioner. Alternatively, such companies, or indeed those proposing to reorganise their business, have the schemes of arrangement choice, proposed by management, which must attract 75% of the shareholder support at meetings ordered by the court. It is acknowledged this process has the appearance of being more complicated than a compromise strategy, but court supervision and a clear programme of steps to be undertaken makes it more effective. Nor is the scheme limited to financial distress and the need for rescue. Mergers, takeovers and debt restructure to avoid potential future financial problems are available to reorganisation scheme planning.<sup>237</sup> The descriptive language used differs from the common terminology, but the tactics of choice of method, between business rescue schemes and corporate compromises remain options.<sup>238</sup>

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<sup>234</sup> Moosa (n 220).

<sup>235</sup> *ibid.*

<sup>236</sup> *ibid.*

<sup>237</sup> Delport and others (n 230) 167-168.

<sup>238</sup> Elizabeth Snyman-van Deventer and Lezelle Jacobs, 'Corporate Rescue: The South African Business Rescue Plan Examined' (2014) 2 Nottingham Insolvency and Business Law eJournal 103, 107-108.



The CA 2008 introduced reforms which make the process of scheme operation simpler and markedly more independent of court oversight. It makes the scheme of arrangement a restructuring method for most corporate needs. Under the previous regime there were, as with the law of the jurisdictions outlined herein, two necessary court approvals, the introduction of the proposal and calling of a meeting, and the final sanctioning of the reorganisation following procedural compliance. Approval is now only required where the nature of its business is regulated by law or specifically required by statute,<sup>239</sup> or on application by dissenting shareholders in the event of an allegation of prejudice or significant irregularity in the process.

Companies have considerably more authority to independently manage change pertinent to their circumstances, without the need for judicial scrutiny of the reorganisation of their operations for international acceptance of the 'new entity'. Removing court oversight is arguably a *prima facie* risk to minority shareholder interests but is ameliorated by the right of appraisal and balances corporate needs for expediency and efficiency. Burdette and Calitz express concern however that this has a political element of motivation in the promotion of company interests at the expense of minority investors, and, particularly in the case of impending liquidation, government ministers may be involved in the appointment of liquidators.<sup>240</sup> The broad freedom is however tempered by the requirement of an independent report, prepared in practice by legal and accounting experts, to assist shareholders in their decision-making in advance of their meeting.<sup>241</sup>

### 3.9.3. Acquisition and Takeover

Sections 112 to 116 of the CA 2008 revised and recreated the scheme of arrangement process to coordinate with international practice and seek to provide for all the needs of modern,

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<sup>239</sup> Gareth Driver and Huneiza Goolam, 'Fundamental Transactions and their Regulation by the Companies Act No 71 of 2008' (Werksman March 2011) <[http://www.companylaw.uct.ac.za/usr/companylaw/downloads/legislation/WLB\\_2011-03\\_Cos\\_Act\\_fundamental\\_transactions\\_GD\\_HG.pdf](http://www.companylaw.uct.ac.za/usr/companylaw/downloads/legislation/WLB_2011-03_Cos_Act_fundamental_transactions_GD_HG.pdf)> accessed 20 September 2019.

<sup>240</sup> David Burdette and Juanitta Calitz, '4:3:2:1 ... Fair Distribution of Appointments or Countdown to Catastrophe? South Africa's Ministerial Policy for the Appointment of Liquidators under the Spotlight' (2015) 3 Nottingham Insolvency and Business Law 437, 439-440.

<sup>241</sup> Driver and Goolam (n 239).

evolving corporations, from liquidation to management of generic growth and acquisition. Section 112 facilitates use of a scheme for the “disposal of all or a greater part of an asset or undertaking” and section 113 to effect an ‘amalgamation or merger’. Section 114(1) indeed provides for full potential reorganisation of the corporate financial foundation, “arrangements between the company and any holders of any class of its securities, including a reorganisation of the share capital of the company”.<sup>242</sup>

The Act provides a choice of flexible mechanisms to restructure corporations, rationalise their financial and business operations, to facilitate expansion and to allow compromises to be reached between companies and their creditors without the need for court supervision. The process for insolvency avoidance, rationalisation and expansion by scheme follows broadly the same procedure for each process as far as meeting and stakeholder involvement is concerned, but it is pertinent first to examine the pre-emptive procedures which may aid avoidance of a financial threat to the company’s existence.

#### 3.9.4. *Financial Distress: The Choices*

In the company rescue context, where there is a risk of dissolution, section 115(1) imposes limitations on the actions of the board and shareholders by, arguably, overriding the powers and authority contained in the registered corporate documentation. For example, “a company may not dispose of all or the greater part of its assets or undertakings, implement an amalgamation or merger, or scheme of arrangement” as each is an act which would potentially prejudice the interests of creditors.<sup>243</sup> Failure to comply will result in the exercise of judicial discretion to decline the scheme, which suggests that upon agreement of the rescue plan and a positive vote the court’s approval must be sought before any substantive action is undertaken by the company. It creates a sense of urgency. The option of takeover by scheme of a failing company is regulated by section 116. The distressed entity effectively disposes of its separate identity and merges its capital assets. Referred to as a ‘compromise’, under sections 128-155 of

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<sup>242</sup> Companies Regulations 2011 (published under the CA 2008) 103.

<sup>243</sup> The CA 2008, Section 115(1). See also Carl Stein and G.K. Everingham, *The New Companies Act Unlocked* (Siber Ink 2011) 294.

the CA 2008 it does not replace the scheme of arrangement as a tool of dealing with potential dissolution but affords an alternate option. It is a pre-emptive preventative mechanism aimed at early intervention in a company's affairs to avoid dissolution and its radiating social effects.

A company will generally be considered 'financially distressed' where liabilities will be outweighed by its assets, and thus insolvent, after six months. In order to seek its prevention, sections 129 and 130 of the CA 2008 enable the board to pass a resolution to appoint a business insolvency practitioner-administrator, provided there is a reasonable prospect of saving it from insolvency through temporary supervision.<sup>244</sup> The company may then enter a voluntary business rescue scheme. A party likely to be affected by the process, normally a creditor, may compel the company to enter into such a scheme, per section 131, by application.<sup>245</sup> The court's power to order the company into a business rescue process is discretionary. Nevertheless, as per section 113, dissenting members and creditors may apply to the court to remove the insolvency practitioner-administrator where (i) the status of 'financial distress' is disputed and the company claimed to be viable, (ii) it is argued there is no basis to expect the proposed plan will rehabilitate the company, or (iii) when the correct procedures for adopting this resolution were not complied with.

There is a process provided for in section 155 of the CA 2008 where the company may seek to reach a compromise with particular creditors similar to the business rescue plan which does not need the instruction of an insolvency practitioner.<sup>246</sup> This is typically employed where the problem is more concentrated around a single creditor issue. More broadly, however, upon the appointment of the administrator, a moratorium is applied against any legal action being taken in respect of its debts, both domestically and, with the order of the court, internationally, as per section 133. Section 145 of the CA 2008, however, requires creditor involvement throughout the administration process, entitling creditors to be informed and to participate in each

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<sup>244</sup> Anneli Loubser, 'The Role of Shareholders during Corporate Rescue Proceedings: Always on the Outside Looking in?' (2008) 20 South African Mercantile Law Journal 372, 379.

<sup>245</sup> Coetzee (n 232) 40.

<sup>246</sup> Hans Klopper and Richard Bradstreet, 'Averting Liquidations with Business Rescue: Does a Section 155 Compromise Place the Bar Too High?' (2014) Stellenbosch Law Review 549, 550.

meeting, court hearing and decision-making process in the business rescue plan. The first creditors' meeting should normally be convened within 10 days of an insolvency practitioner being appointed. At this meeting, the insolvency practitioner must give a calculated opinion on the prospects of saving the company. Creditor support requires 75% of voting interests in addition to 50% of independent creditors.

South African schemes of arrangement are ideal for insolvent companies or for those in financial distress; it is a highly flexible tool adaptable to a wide range of corporate restructure and organisation. South Africa thus presents itself as a model jurisdiction for the use of schemes of arrangement and emphasises its ability to reform and modernise companies.

### **3.10. Conclusion**

Throughout this chapter the intention has been to examine and review the approaches of diverse jurisdictions to corporate restructure and rescue, identify similarities in procedures and differences in the legal frameworks which arise from their individual market needs and commercial cultures. An aim has been to ascertain the potential for a globally accepted, international law format. The review has highlighted common themes in national schemes which support the contention of the study that statutory schemes of arrangement represent a powerful, flexible and adaptable method of facilitating corporate restructuring. They provide a specific attraction for foreign business to change their financial base, organise the structure of their practices and generally renew themselves as their needs in the market change. The regular, commercial review of legislation is necessary to meet changing demands.

This chapter's discussion leads to the conclusion that the Saudi Bankruptcy Law must meet four core aspects of schemes of arrangement to enhance the attractiveness of this method in the context of alternative structures for insolvency, rescue, acquisition, takeover, refinancing and a *plethora* of corporate development needs. The first is the protection of minority interests, those of shareholders, creditors and investors who do not have the financial power or authority of the major company financiers and share owners. In developing a legislative framework, degrees of protection differ, and this will have to be balanced in the KSA system. This is

important to maintain confidence that schemes will not be abused by corporate controllers, particularly in the use of a cram-down procedure which binds potentially reluctant or dissenting minorities to the interests of corporate rescue.

This is related to the **second** common aspect of a scheme, the vote, and whether it should be based on value of holding or simple headcount, one member-one vote, which would allow minor members the same level of influence as that afforded to those with a considerable financial stake by value. Current voting procedures in the UK and many of the other jurisdictions requiring a special majority of 75% of voters by headcount in their classes to favour the implementation of a scheme needs to be reviewed. There is a strong argument that 75% of voter value of attendees should be sufficient to carry and approve the scheme to avoid minorities with small investments tactically thwarting the will of the majority by simple attendance at the creditor meeting. A more effective process would include facilitating the use of proxies or electronic voting to alleviate the headcount problem.

The **third** consideration is the role of the courts which must have a more active role in review to ensure the law is honoured with fairness and reasonability. There is already considerable scrutiny of the scheme information disclosure process. The court must protect against sabotage where the interests of the company are served by the scheme proposal providing a transparent process to scrutinise activation and enforcement. In the UK, in *Bibby Offshore Services Plc*, for example, a single creditor attempted to liquidate a debtor company's assets to recover his capital, but his application was refused, enabling the scheme to be given the chance to succeed.<sup>247</sup> Similarly, in *Far East Capital Ltd SA*<sup>248</sup>, a scheme was deemed effective although the company held its assets in other jurisdictions. In Bermuda, the Supreme Court in *Up Energy Development Group Limited*<sup>249</sup> adjourned a liquidation meeting to allow the scheme plan, duly and procedurally approved, to be effected. The involvement of the courts is vital to ensure the balance between the societal and economic interests of company survival with sufficient legal

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<sup>247</sup> [2017] EWHC 3402 (Ch).

<sup>248</sup> *Far East Capital* (n 12).

<sup>249</sup> [2017] SC (Bda) 85 Com.

protection to other interests in the adoption of a scheme. Financial distress is potentially resolvable in the face of internal company resistance. Payne further emphasises the need for courts to impose limitations on the actions of all involved in the scheme, ensuring balance be it on a scheme for debt rearrangement or structure rationalisation.<sup>250</sup> It has been noted in *Prudential Assurance Company Ltd*<sup>251</sup> that the UK courts will not automatically use their discretion to approve schemes despite careful planning and compliance when there are interests they consider override financial considerations. The **fourth** core principle is standardisation, with variations designed into the legislation of each provider country to adapt to the needs of local, regional commerce and attract the international community by the offer of an adaptive procedure. This essentially brings the examination and review back full circle. The involvement of the courts is integral to the legitimacy of corporate reorganisation and the recognition of the emerging entity in the international law arena. There is little point in restructuring the liabilities of a global organisation if this is only effective in the jurisdiction where it was undertaken. This was seen in *Avanti Communications Group Plc*<sup>252</sup> which involved the recognition of a UK scheme restructure even though there was no comparable legislative basis in US law.

It is expected that, using the review findings of this study as a whole and the experiences of other jurisdictions, the Saudi process will operate as an effective, specialist, adaptable source of corporate restructure facilitation, meeting the key aims of streamlining, improvement and international recognition with the consequent growth in the commercial and legal sectors of the national economy. The Saudi law will be examined in the next chapter. It is a system that is still developing based on broad-based economic reform to compete in global markets with greater diversity of business operations and to attract international companies.

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<sup>250</sup> Jennifer Payne, 'The Role of the Court in Debt Restructuring' (2018) 77(1) Cambridge Law Journal 124, 125.

<sup>251</sup> [2019] EWHC 2245 (Ch).

<sup>252</sup> See *Avanti Communications Group Plc* (n 10).

## **4. Chapter IV: Corporate Restructuring in the Kingdom of Saudi Arabia**

### **4.1. Introduction**

The aim of this chapter is to evaluate how corporate restructuring under the new Bankruptcy Law 2018<sup>1</sup> (BL 2018) develops and updates the prior complex provisions of the Saudi legal framework to accommodate the modern needs of a business facing financial distress, principally its need to restructure its business model. It will examine and evaluate where this provision of the modernising Vision 2030 initiative<sup>2</sup> on commercial reform places the Saudi law on track with the international schemes of arrangement and how it is effected as a fair, ethical and interests-balanced formula of corporate rearrangement and a global standard for international trade. The frameworks of schemes of arrangement reviewed in the last chapter are indicative of a competitive environment in terms of flexible, adaptive reconstruction via schemes of arrangement. Although the term ‘scheme of arrangement’ is not used in the Saudi BL 2018, Preventative Settlement and Financial Restructuring procedures are similar in substance to the international provisions for companies requiring debt reorganisation for survival.

In the context of the Vision 2030, the seventh theme’s strategic objective of the National Transformation Program 2020 (NTP 2020) embeds in government policy the economic need to “develop and implement regulations and processes that remove hurdles to start, run, develop, and exit a business, and provide needed protection to businesses (e.g. contract enforcement, bankruptcy, shareholder protection)”.<sup>3</sup> This required addressing the need for substantial fundamental reform not simply of the law but of government attitudes to control over business, their commercial operation and their ability to raise finance and own assets. These issues posed considerable disincentives to foreign corporations to invest and conduct business in the territory, which was the state’s reason to address this with these 21<sup>st</sup> century initiatives.

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<sup>1</sup> Royal Decree No M/05 of 28/05/1439 (13/02/2018).

<sup>2</sup> Saudi Arabia Vision 2030 <[vision2030.gov.sa/en](http://vision2030.gov.sa/en)> accessed 20 September 2019.

<sup>3</sup> Saudi Arabia National Transformation Programme 2020 <[vision2030.gov.sa/en/ntp](http://vision2030.gov.sa/en/ntp)> accessed 20 September 2019.

The Vision 2030 places considerable emphasis on employment and the need for a vibrant private business sector, spurred on by foreign and domestic investment which demanded a more corporate-friendly legal environment.<sup>4</sup> It is an onerous task as it must balance the demand for the cultural preservation of values.

Business requires stability to thrive, the provision of incentives and an economy and legal infrastructure which encourages and attracts investment. The state must aim for an ease of 'doing business' culture, create an environment for non-oil growth and plan for when oil revenues start to dwindle.<sup>5</sup> The Vision 2030 initiative is "to create an attractive environment for both local and international investors and enhance their confidence in our economy".<sup>6</sup> Corporate law, commensurate with the needs of commerce, is most fitting and attractive when it assists in the provision of problem resolution: 'a friend in need is a friend indeed'. In terms of corporate governance, the principles of fairness, accountability, responsibility and transparency are problematic for reasons of tradition and culture in Saudi company management, but a 'competitive imperative' is acknowledged as necessary to attract international customers and investors.<sup>7</sup> This has a considerable impact on the operation of the law, those same ethics expected in times of distress and rescue.

This chapter will therefore seek to evaluate the efficacy of recent corporate law reform in the KSA. This applies as much to governments in the provision and development of credible legal processes and internationally accepted and respected outcomes as it does to companies seeking rearrangement of obligations, rescue, structural adaptation and new markets. It will analyse whether Saudi law reform meets the needs of national and international corporations to reorganise capital and financial obligations, acquire corporate assets, broker a takeover and

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<sup>4</sup> Graham Nelson and Mohammed Negm, 'The New Saudi Arabian Bankruptcy Law' (Altamimi & Co 30 March 2018) <<https://www.tamimi.com/wp-content/uploads/2018/04/Law-Update-March-Edition.pdf>> accessed 20 September 2019.

<sup>5</sup> Amgad Hegazy, 'Economic Diversification in Saudi Arabia: The Past, the Present, and the Way Forward' in Ahmed Al-Darwish and others (eds), *Saudi Arabia: Tackling Emerging Economic Challenges to Sustain Growth* (International Monetary Fund 2015) 73-77.

<sup>6</sup> The NTP 2020 (n 3).

<sup>7</sup> Edward Burton, *Business and Entrepreneurship in Saudi Arabia: Opportunities for Partnering and Investing in Emerging Businesses* (John Wiley & Sons 2016) 94.



grow. **Four** particular areas of the application of the law are examined: (i) an exploration of the origin, principles and trends of corporate law and company reconstruction in the Kingdom; (ii) within the cultural and religious context of Saudi Arabian society and commerce, an exploration will be undertaken of the effect of strict adherence to Islamic law (*Shari'a*) and its application to the corporate restructure process given its considerable effect on obligations and liabilities; (iii) a comparative review will be undertaken of the company restructure and scheme of arrangement reforms in the context of those frameworks adopted by other nations reviewed before; and (iv) conclusions and insights will be offered into the competitive effect and value of the developing legal framework of schemes in the international context.

#### **4.2. Corporate Restructuring**

Prior to the protracted path to membership of the World Trade Organization (WTO), the KSA was described as a paradigmatic capital- and resource-rich state.<sup>8</sup> The commercial framework was structured to suit the national needs in the first instance, with the aim of diversifying into the global market with a mixed economy. An evaluation of the economic, corporate and legal corporate structure is arguably best made by the user, and Montagu notes that the commercial environment had expanded so quickly in the last decades that the law had failed to keep up with its needs.<sup>9</sup> The rigours of preparation for the lengthy process of WTO membership required considerable government attention to updating the KSA corporate law for the new century, with rationalisation a key objective.<sup>10</sup> The KSA lacked a modern, fit-for-purpose insolvency regime.<sup>11</sup> It was largely dependent on the somewhat idiosyncratic negotiations of corporate owners and their creditors in a process which had limited effective, independent oversight.<sup>12</sup> The disparate corporate law provisions failed to accommodate informal arrangements for the reorganisation of liabilities, lacked a priority structure for debt repayment

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<sup>8</sup> Steffen Hertog, 'Two-level Negotiations in a Fragmented System: Saudi Arabia's WTO Accession' (2008) 15(4) *Review of International Political Economy* 650, 652.

<sup>9</sup> Caroline Montagu, *Saudi Arabia on the Road to Reform* (DTI 2001) 48.

<sup>10</sup> *ibid.*

<sup>11</sup> Turki A Alshubaiki, 'Developing the Legal Environment for Business in the Kingdom of Saudi Arabia: Comments and Suggestions' (2013) 27 *Arab Law Quarterly* 371.

<sup>12</sup> *ibid* 389.

and attracted a high number of legal actions.<sup>13</sup> In order to attract business to the KSA, the law and corporate procedures had to change.

Hegazy praises the diversification of the KSA economy from a nation heavily revenue reliant on a single finite natural commodity to the development of an investment, manufacturing and commercial infrastructure financed with oil wealth and open for business on international markets.<sup>14</sup> The proportion of non-oil business contribution to the national Gross Domestic Product (GDP) is just short of half, but much, over two thirds, is financed by government initiatives and sponsorship – a rather unstable source of support.<sup>15</sup> Habib and Abidin note that the KSA government was the primary consumer in the economy whilst controlling the laws which regulated the same, and 77% of the citizens believed it was the arbiter of success or failure of business enterprises, depending on its own needs.<sup>16</sup> In order for small businesses to succeed, detailed knowledge of the traditional cultural imperatives of Saudi corporations and an intricate knowledge of the diverse idiosyncratic legal system was required. In its absence, this hindered the development of domestic entrepreneurialism and foreign investment.<sup>17</sup> To establish a strong small- and medium-sized enterprise (SME) private business structure which would attract domestic entrepreneurs and foreign investors as envisaged by the Vision 2030 initiative, the Kingdom had to overhaul its investment strategy and public funding programme and tap the international financial markets.<sup>18</sup>

#### 4.2.1. *Origin and Trends*

Corporate law and commercial practice in the KSA lacks the historical experience of the UK and other national jurisdictions reviewed in Chapter III. Prior to the enactment of the Settlement

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<sup>13</sup> Nelson and Negm (n 4).

<sup>14</sup> Hegazy (n 5) 61.

<sup>15</sup> Rima Bhatia, 'Saudi Arabia Non-Oil GDP Economic Sector Analysis' (Gulf's International Bank April 2017) <[https://gib.com/sites/default/files/saudi\\_-\\_non-oil\\_-\\_draft\\_28\\_spread\\_-\\_for\\_web\\_0.pdf](https://gib.com/sites/default/files/saudi_-_non-oil_-_draft_28_spread_-_for_web_0.pdf)> accessed 20 September 2019.

<sup>16</sup> Ghazi Habib and Adnan Abidin, 'Bankruptcy of Saudi Corporations: The Causes and Resolutions (1987) Arab Journal of Management 152, 154.

<sup>17</sup> Rayed Alghamdi and others, 'Factors Influencing E-commerce Adoption by Retailers in Saudi Arabia: A Quantitative Analysis' (2012) 3 International Journal of Electronic Commerce Studies 83.

<sup>18</sup> Bhatia (n 15) 11.

Against Bankruptcy Law<sup>19</sup> (SABL 1996), companies had to seek rescue or an orderly demise within a diverse range of national and regional laws and practices which incorporated procedural flaws of inconsistency when seeking to balance the financial and religious obligations with the rights of creditors, interests of investors and the needs of the corporation. Debtors and creditors reached their own agreements in private settlements across diverse contractual and corporate law provisions of the unsuited to financial distress contexts and disparities of powers of negotiation, or simply turned to *Shari'a* principles for resolution.<sup>20</sup>

The SABL 1996 was enacted with a view to overcoming the diversity of principles in dealing with the liquidation of companies inherent in the general corporate structure of Chapter 10 of the Commercial Courts Law 1931<sup>21</sup> (CCL 1931) and the inadequacies of the Commercial Law 1965 (CL 1965).<sup>22</sup> The legislation did not differentiate between financial distress and insolvency, a distinction that is commonly avoided in more mature insolvency law frameworks due largely to the potential legal action and penalties for wrongful trading in the latter circumstances. The distinction, nevertheless, plays a vital part in the assessment of the prospects for corporate rescue. The lack of clarity in procedure allowed more powerful and better informed creditors to enter into arrangements that were binding on dissenters who had no control over their fates. This made it problematic for financially distressed, rather than insolvent, companies to better manage classes of creditor interests with a view to establishing a path to survival.<sup>23</sup> This level of insecurity of interest protection, threat of insolvency and undermining of corporate control was a considerable disincentive for foreign companies to invest in the state. The CL 1965 enactment to establish principles of corporate governance<sup>24</sup> did little to improve the clarity of the operation of prior legislation.

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<sup>19</sup> Royal Decree No M/16 of 04/09/1416 (24/01/1996).

<sup>20</sup> Nelson and Negm (n 4).

<sup>21</sup> Royal Decree No 32 of 15/01/1350 (01/06/1931).

<sup>22</sup> Royal Decree No M/6 of 17/03/1385 (14/7/1965).

<sup>23</sup> Bob Wessels, Bruce Markell and Jason Kilborn, *International Cooperation in Bankruptcy and Insolvency Matters* (Oxford University Press 2009) 169.

<sup>24</sup> Royal Decree No M/6 (n 22).

The 1996 legislation was designed to stabilise the system for dealing with potential financial distress and protections of diverse corporate interests. It may be viewed as part of the ten years of legal and economic infrastructural work of the Kingdom to join the WTO.<sup>25</sup> The SABL 1996 was arguably the first, albeit contextually limited, legislative move by the government to address the need for a more flexible process for regulating the demise of failing companies. It was indeed a relatively new legislative concept in the Middle East. It formed part of a review to upgrade corporate law and practice to improve the attractiveness and diversity of the country's investment climate and end dependence on oil. Nevertheless, Bader noted in 2004 that the commercial perception of liquidation remained predicated on ineffective, bad management, inadequate levels of experience, poor policy decision-making, neglect and even fraud.<sup>26</sup>

Fault for the failure of a business enterprise and the resultant loss to creditors and members was blamed on the management. The non-oil economy was founded on family business, some of these being the personal conglomerates of autocratic directors, a paternalistic corporate structure which reflects the cultural and heritage traditions of Saudi Arabian society.<sup>27</sup> Malaika paints an unattractive picture of self-centredness and priority of fulfilment of the personal interests of the management before company, imbued with nepotism, favouritism and the demand for personal loyalty.<sup>28</sup> The individualistic style of conflict and confrontation avoidance, coupled with a desire for informality in dealings, arguably explains the lack of willingness to face up to financial problems and legislative intervention. It has been noted herein that religious attitudes to debt are relatively benign provided that it is properly managed.

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<sup>25</sup> Steve Charnovitz, 'Mapping the Law of WTO Accession' (George Washington University Law School 2013) <[https://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=1430&context=faculty\\_publications](https://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=1430&context=faculty_publications)> accessed 20 September 2019.

<sup>26</sup> Mohammed Bader, 'Causes of Contractors' Failure in Saudi Arabia' (King Fahd University of Petroleum and Minerals, Report CEM 520 December 2004) <[http://faculty.kfupm.edu.sa/CEM/assaf/Students\\_Reports/Causes-of%20Contractors-Failure-in.pdf](http://faculty.kfupm.edu.sa/CEM/assaf/Students_Reports/Causes-of%20Contractors-Failure-in.pdf)> accessed 20 September 2019.

<sup>27</sup> Abdulaziz M Malaika, 'Management Characteristics and Organisation Context in Saudi Arabia' (Loughborough University of Technology February 1993) <<https://dspace.lboro.ac.uk/dspace-jspui/bitstream/2134/7298/2/DX176070.pdf>> accessed 20 September 2019.

<sup>28</sup> *ibid* 212.

The processes of the SABL 1996 and the application of the BL 2018 are predicated on the priority of *Shari'a*, the legal foundation of the KSA.<sup>29</sup> *Shari'a* is not simply a statement of faith law but a code by which life and behaviour is regulated.<sup>30</sup> Judicial decision-making is based on a combination of civil law and *Shari'a* principles, applied to the particular facts of the case before it and, of considerable significance to foreign investors, made without reference to precedent and in private, without publication of the adjudication.<sup>31</sup> The interaction of judicial interpretations, individually applied to the circumstances of corporate issues before the courts, with priority over civil decrees, makes precedent elusive.<sup>32</sup> Such uncertainty might be unattractive for directors facing potential penalties for corporate failure.

In the context of bankruptcy, the expectation is simple: "O you who have believed, fulfil [all] contracts".<sup>33</sup> English historical attitudes to non-payment of debt were equally if not more strict in their legal and societal condemnations and punishment, from Henry VIII, in his Statute of Bankrupts 1542, to the Victorian debtors prison.<sup>34</sup> Imbued with the principles of social justice and responsibility, and the demand for charity and understanding, both debtors and creditors are expected to allow the opportunity for fulfilment of obligations.<sup>35</sup> This is provided for by the benefit of time and respite, which are indeed abiding principles in the BL 2018. The demand for debt payment had been accompanied by a certain suspicion and the need to investigate the truth about insolvency and inability, imprisonment potentially used in the interim determination period.<sup>36</sup> There are no figures available for how often this option was used to

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<sup>29</sup> Jonathon Burns and Mahmoud Abdel-Baky, 'Saudi Arabia: Officers and Directors Liability under the New Companies Law' (Dentons 19 May 2016) <<https://www.dentons.com/en/insights/alerts/2016/may/19/saudi-arabia-officers-and-directors-liability-under-the-new-companies-law>> accessed 20 September 2019.

<sup>30</sup> Abed Awad and Robert Michael, 'Ifas and Chapter 11: The Classical Islamic Law and Modern Bankruptcy' (2010) *International Lawyer* 975, 980.

<sup>31</sup> Burns and Adel-Baky (n 29).

<sup>32</sup> Awad and Michael (n 30) 978.

<sup>33</sup> Holy Quran, Verse 5:1.

<sup>34</sup> University of Pennsylvania Law Review and American law Register, 'The Early History of English Bankruptcy' (1919) 67(1) *University of Pennsylvania Law Review* 1 <[https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=7675&context=penn\\_law\\_review](https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=7675&context=penn_law_review)> accessed 20 September 2019.

<sup>35</sup> Awad and Michael (n 30) 980.

<sup>36</sup> *ibid* 998.

deal with simple impecuniosity or more dishonest practices, but certainly the former justification is ameliorated under the BL 2018.

The regional rivalry of state culture and practices also led the OECD (Organisation for Economic Co-operation and Development) in 2009 to consider the law administratively complex and cumbersome, full of loopholes and “inefficient, with investigation procedures differing from one district to another”.<sup>37</sup> Indeed, it was only in 2007 that an independent Commercial Court was established to specifically draw the resolution of corporate law into a specialist jurisdiction.<sup>38</sup> Less formal arrangements between distressed companies and creditors tended to eschew legislative oversight in preference for private arrangements, evidenced by the low uptake of the procedure by insolvent companies.<sup>39</sup>

#### 4.2.2. ‘Old’ Legislative Framework

It is not proposed to consider what may be termed as ‘old law’ simply to examine out-of-date principles which *prima facie* have no application to the Saudi corporate bankruptcy process in 2018. Indeed, it is suggested that the corporate law framework was simply a reflection of a fundamentally *laissez faire* conduct of the national economy which broadly left the conduct of business inadequately regulated and somewhat adrift in the global markets. This is perhaps exemplified by the financial services industries, which are the producers of considerable revenue wealth in major western nations. Despite WTO membership and huge economic wealth and power in the Middle East, it was not until the second decade of the 21<sup>st</sup> century that the KSA began to transform its business structure to take its rightful place in a diverse, interactive global market.

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<sup>37</sup> Hawkamah, World Bank, OECD, INSOL International, ‘Study on Insolvency Systems in the Middle East and North Africa’ (OECD 2009) 50 <<http://www.oecd.org/corporate/ca/corporategovernanceprinciples/44375185.pdf>> accessed 20 September 2019.

<sup>38</sup> Royal Decree No M/87 of 19/9/1428 (1/10/2007) art 9.

<sup>39</sup> Mahesh Uttamchandani, “‘No Way Out’: The Lack of Efficient Insolvency Regimes in the MENA Region’ (World Bank, Policy Working Paper 5609 March 2011) 4 <<http://documents.worldbank.org/curated/pt/642091468275109962/pdf/WPS5609.pdf>> accessed 20 September 2019.

Much of the brief review above and indeed wider academic and legal criticism suggest a somewhat complex and unsatisfactory set of legal processes imbued with religious interpretation, especially given the criminal status accorded to unpaid debt.<sup>40</sup> It is, however, worthy of note that the *Shari'a* principles of honesty, fairness, good intentions, just dealing and understanding<sup>41</sup> pervade the new law, BL 2018, as they did the SABL 1996. This includes the requirement of an expression of 'charity' and understanding on the part of creditors in permitting time for debt resolution, a moratorium on actions and prohibition on *riba*.

It is suggested that there is no sacrifice of religious principles in the BL 2018, which was undertaken to boost commercial attractiveness, and it is argued that much of the genesis of the BL 2018 was already inherent in the SABL 1996, just appallingly complicated and disjointed. The BL 2018 is not considered a consolidation of the SABL 1996, but a modern international framework of good corporate practice and service, a logical progression of modernisation.

The categories of activity which lead to bankruptcy arguably still attract a similar level of religious opprobrium where debts remain unpaid due to the actions of corporate management. This attitude was that the only real, potentially justifiable reason for bankruptcy was misfortune that carried no personal blame, and upon repayment of debt the freedom to trade was preserved.<sup>42</sup> This was not a right of those involved in (i) 'extravagant waste' by unconscionable risk taking or speculation,<sup>43</sup> or (ii) 'fraud' and criminal behaviour in the utility of company assets.<sup>44</sup> These definitive categorisations of reasons for corporate bankruptcy, and subsequent loss to creditors, appear to reflect a rather inflexible legal attitude towards the multifarious reasons for company failure in a competitive global market. They appear not to recognise the effect of international competition on domestic-based, government-controlled Saudi

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<sup>40</sup> Omaro Alomaro, 'The Legal Effects of the Bankruptcy of Companies' (Unpublished Master Thesis, Institute of Public Administration 2001) 26.

<sup>41</sup> Saad Althiabi, 'The Priceable of Good Faith in Saudi Law: A Comparative Study with Other Laws' (2014) 23 *Journal of Sharia, Law and Islamic Studies* <<http://dspace.iaa.edu.sd/handle/123456789/347>> accessed 20 September 2019.

<sup>42</sup> Royal Decree No 32 (n 21) art 105.

<sup>43</sup> *ibid* art 106.

<sup>44</sup> *ibid* art 107.

companies in the mid-20<sup>th</sup> century, which may not be equipped to cope with such pressure.<sup>45</sup> They do, however, have the inherent legal capacity to differentiate between external competitive factors and internal inadequacy of personal management, somewhat compromising the power of the corporate veil in the interests of religious-based probity of behaviour.

It was the misuse of corporate assets which had been the major source of concern for Saudi shareholders and creditors and their need to protect their respective investments from continuing harm.<sup>46</sup> In the absence of any effective intervention or restructuring process, the only recourse under the CCL 1931 was to seek a bankruptcy declaration to distribute assets, effectively ending the enterprise.<sup>47</sup> Imprisonment was also a penalty available to punish management for their harmful acts, ranging from 3 months to, in the case of dishonesty, 5 years, in a disparate judicial framework of jurisdictions. It can be noted that at the time, 1931, the KSA economic framework had little experience of small private business enterprises and their needs, or indeed international corporate entities based as independent business units in the Kingdom. The law, its penalties and opprobrium would arguably fall on state sponsored businessmen. The KSA economy was thus structured along the lines of Islamic financial values. Nevertheless, imprisonment remains the ultimate sanction in the BL 2018.<sup>48</sup>

The CL 1965 undertook a comprehensive expansion of directorial corporate responsibility and governance program whilst enhancing the limited liability of shareholder investors in terms of what such owners would have to pay in the context of liquidation, according to the extent of their interest in the capital.<sup>49</sup> Such limited liability, given the religious duties and protection of creditors, was not absolute however, and should the company wish to continue trading an agreement had to be effected to discharge debts in accordance with share capital contribution.

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<sup>45</sup> Habib and Abidin (n 16) 152-153.

<sup>46</sup> Nicolas Bremer, 'Liability of Managers and Directors under Saudi Arabian Law' (Alexander and Partner Rechtsanwälte 19 December 2016) <<https://www.lexology.com/library/detail.aspx?g=2a826db6-ae7e-47d0-bb92-d4cef385c9f4>> accessed 20 September 2019.

<sup>47</sup> Alomaro (n 40).

<sup>48</sup> The author has been unable to obtain government statistics relating to the enforcement of such a sanction since their introduction in 1931.

<sup>49</sup> Royal Decree No M/6 (n 22) art 157.



Specifically, Article 180 of the CL 1965 requires that the directors of a limited liability company facing losses of between half and three quarters of its capital convene a meeting of shareholders within 90 days to consider whether the company should continue to run its trade, and thus remain under obligation to repay the company's debts, or be dissolved.<sup>50</sup> If the decision is in the affirmative, to continue trading and indeed it does so, they would become jointly liable for the repayment of all the debts of the company.<sup>51</sup> In the UK, to continue to operate in the face of insolvency could constitute wrongful trading. This provision appears to offer some immunity to directors from the criminal penalties that would ordinarily be incurred but it does not exonerate them from personal obligations to the creditors who are liable to suffer.

The protection of creditors and discharge of debts are principles carried into the 2018 legislation, including the proportional liability for all debts, save for some variation in this particular application. In the event of bankruptcy and seizure of assets overseen by the court, an association of creditors will be established to ensure fair, proportionate distribution of the same to those owed by the company.<sup>52</sup> What is missing, however, is an effective structure by which the company is rescued, arguably the most socially and economically appropriate manner of preserving the financial interests of all parties and the state.

This is addressed in the SABL 1996, which may perhaps be seen as a first step on the path to effective involvement in the diverse international trade structure as preparations began for entry into the WTO. In the context of seeking a solution to corporate financial distress, Article 2 stipulates that:

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<sup>50</sup> *ibid* art 180.

<sup>51</sup> Abdulmalik Aljasir, 'Jurisdictions in Business Bankruptcy Dispute Resolution' (The Research Excellence in Contemporary Jurisprudence Centre at IMAMU 2018)

<<https://units.imamu.edu.sa/rcentres/rces/fileslibrary/PublishingImages/Pages/default/الاختصاص%20وتنازعه%20بين%20الجهات%20القضائية.pdf>> accessed 20 September 2019.

<sup>52</sup> Saleh Al-Osaimy, 'Settlement Against Bankruptcy: A Comparative Study Between the Saudi Law and the Egyptian Law (Unpublished Master Thesis, Faculty of Economics and Management – Systems Division, University of King AbdulAziz 2000) 16.

“... if an amicable settlement cannot be reached, or if the merchant, whether an individual or a partnership, sees that it is in their best interest to initially seek protective settlement against bankruptcy, they may petition the Board of Grievances ...”

The terminology used in this provision is rather ‘loose’ insofar as its application to companies is concerned, using, it is argued, ‘partnership’ to include all forms of partnership in Saudi Law, including companies.

It is suggested that this is to ensure creditors are aware that ultimately there is a choice of methods, should statutory criteria be met, to protect their investment. The purpose of the 1996 legislation is, in common with the scheme of arrangement laws and processes in the jurisdictions reviewed in Chapter III, the rescue of the company and its continued trading, revenue production and employment provision, et al. There should be a differentiation in rescue procedures oriented toward the preservation of the company itself by restructure and reorganisation, and that of business rescue, where the insolvent corporate entity no longer trades but its business is sold as a going concern.

There is no clear differentiation in the Saudi legal framework which would enable emphasis to be placed on corporate rescue, and in the absence thereof, management of decline can be piecemeal and destructive to stakeholder economic interests. The facilitation of mergers between companies as a method of resolving financial problems was starting to enter the legal arena at that time, albeit through a rather disjointed procedure.<sup>53</sup> It was a promising development but nevertheless failed to adequately distinguish the takeover for expansion and business growth from distress rescue. In terms of the restructure of corporate operations and debt, Articles 2 and 7 of the SABL 1996 did provide the opportunity to petition the court for approval but the emphasis remained on the risk of bankruptcy and distress reorganisation rather than corporate management needs, for example, to restructure after growth, halt decline or merge.

Article 1 of the SABL 1996, albeit in a very limited legislative form, provided companies still trading and discharging their liabilities with a procedure by which to avoid insolvency arising

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<sup>53</sup> Royal Decree No M/6 (n 22) arts 213-215.

from severe financial difficulties. It implemented concepts of forgiveness and patience on the part of creditors in order to facilitate a contract with the distressed debtor company, which was confirmed and overseen by the court and an external appointed trustee.<sup>54</sup> Such an agreement would include identification of problematic debts, their potential reduction, the resetting of installment payments and their postponement, emphasising good faith and cooperation with a view to the continuation of the company.<sup>55</sup> Indeed, before formally involving the court, the regional Chambers of Commerce set up advisory and conciliation committees to assist with dispute resolution.<sup>56</sup> They were empowered to consider financially distressed company accounts and identify the problems which led to corporate difficulties to facilitate liaison with creditors and process out-of-court agreements.<sup>57</sup> However, there still remained reluctance on the part of businesses to use the specific corporate distress resolution processes due to the lack of clarity of procedure, variations in regional application and the significant government role in company affairs.

The postponement of debt repayments is agreed within the strictures of *Shari'a* compliance. The settlement agreement must attract the approval of two thirds of creditors according to value<sup>58</sup> before it would apply to all, whether active in the negotiation process or not.<sup>59</sup> The 'headcount' process is eschewed in the calculation of the special majority, reflected in the new BL 2018 process. The Chamber of Commerce for the region would ensure that all affected parties are notified of the creditors meeting but need only seek to organise and ensure that consenting participant respondent interests are reflected in the agreement.<sup>60</sup>

The SABL 1996 procedure is similar to the BL 2018 in its Islamic-based framework and in its application, emphasising religious values of trust, good faith and cooperation that are attractive

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<sup>54</sup> Royal Decree No M/16 (n 19) art 2.

<sup>55</sup> *ibid* art 3.

<sup>56</sup> *ibid* art 1.

<sup>57</sup> Riyadh Newspaper, 'The Minister of Trade Approves the Formation of a Committee of Friendly and Protective Bankruptcy in Jeddah Chamber' (Riyadh News Paper, Issue No 14220 31 March 2007) <<http://www.alriyadh.com/253640>> accessed 20 September 2019.

<sup>58</sup> Royal Decree No M/16 (n 19) art 7.

<sup>59</sup> *ibid* art 9.

<sup>60</sup> Al-Osaimy (n 52) 91.

to international business. In summary, a plan is prepared by the debtor company for its reorganisation proposals that is then submitted to the court which will require creditors to be fully informed and notified to meet to negotiate. The resultant agreement must be approved with a two-thirds value creditor majority of participants.<sup>61</sup> Although neither the presiding judge nor the overseeing trustee need take account of the interests and wishes of non-participating, non-voting or dissenting creditors, Article 9 demands their debts and entitlements are satisfied before the settlement period is concluded.<sup>62</sup> The court will, as in the UK, generally approve an arrangement that is compliant with procedural requirements, and the company will emerge revitalised by its release from some obligations and variations in others.<sup>63</sup>

Transparency, disclosure and good faith on the part of the debtor and creditor are demanded throughout the process, with the trustee continuing to monitor the satisfaction of the settlement terms until such time as all outstanding obligations are fulfilled by the debtor.<sup>64</sup> The role of the trustee is to 'trust, but check' and ensure that the company does all within its power to avoid the opprobrium and financial consequences for its stakeholder of bankruptcy.<sup>65</sup> A breach will result in revocation, compliance is strict and taken seriously and given the personal penalties to befall management efforts are expected to be directed to success of the agreement terms and rescue.<sup>66</sup>

On satisfaction of liabilities, the company is released and it is back to business as usual.<sup>67</sup> Perhaps a more apposite description is that business carries on as before. In the absence of recklessness or dishonesty in the financial distress, the management of the company will continue to run the business as a going concern with the aim of maintaining continuity and

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<sup>61</sup> Royal Decree No M/16 (n 19) arts 2-13.

<sup>62</sup> *ibid* art 9. Also, this reiterates the provision of Article 129 of the CCL 1931: 'A judge cannot force a creditor to accept an agreement, but must ensure his rights are protected and debt repaid.'

<sup>63</sup> Abdulrahman Gurman, *Negotiable Instrument, Bankruptcy and Preventive Settlement* (4<sup>th</sup> edn, Arab World Library 2015) 376-382.

<sup>64</sup> Implementing Regulations of the Settlement Against Bankruptcy Law (2004) arts 14-16.

<sup>65</sup> Al-Osaimy (n 52) 91-92.

<sup>66</sup> Gurman (n 63) 401.

<sup>67</sup> Royal Decree No M/16 (n 19) art 13.

satisfying the liability agreement.<sup>68</sup> This is reflected in the BL 2018 and is subject to limitations on activities designed to protect creditors should the company fail. The directors may not carry out individual deals with creditors, or encumber property with new mortgages, or serve as guarantors for the debts of others or transfer assets, at least without the consent of the trustee.<sup>69</sup>

The restructure of the state legal system in the 21<sup>st</sup> century was a response to the need to diversify The KSA domestic and international market, in so doing attracting direct foreign investment from multinational corporations.<sup>70</sup> However, reliance on the global market creates dependency risks and so initiatives were put in place to encourage Saudi entrepreneurship. This facilitated the growth of domestic SMEs which was helped by greater access to finance through a reorganised banking system and the need for more effective debt management practices. Mergers between Saudi-based enterprises and international partners were becoming a more significant part of the legal framework, be it for expansion or rescue from distress. Essentially, the law needed to 'catch-up' with corporate needs arising from WTO membership; the global economic crash of 2008; the increasingly volatile oil price; and the relentless globalisation of trade. In the context of potential insolvency, mergers and acquisitions, takeovers and corporate restructure the needs of domestic and international corporations are in a situation of constant flux. The KSA legal system was developing but was proving complex and unpopular. Services of share transfer, asset amalgamation, dissolution processes and mergers needed to be more imaginatively formulated and clearly effected. It is thought this was the stimulus behind the BL 2018.

There were also concerns about the level of expertise of the KSA judiciary in dealing with corporate law and complex business affairs, particularly given the dependence on *Shari'a* which was directly geared toward ensuring compliance of civil law with Islamic principles. The Capital

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<sup>68</sup> *ibid* art 5.

<sup>69</sup> Gurman (n 63) 376.

<sup>70</sup> Abdoh Alasmari, 'Financial Report: Saudi Arabia is the First Country in the Arab World to Diversify Investments' (Sharq Newspaper, Issue No 687 21 October 2013) 17 <<https://issuu.com/alshrq/docs/131020215526-766674bf83fb416dbe6be2ac1bbb8d15>> accessed 20 September 2019.

Market Authority (CMA), formally established in 2003, aims to develop confidence and trust in the transparent operation of business entities to encourage investment in accordance with the KSA laws and Islamic principles.<sup>71</sup> It provides supervision of listed companies in the promotion of governance principles, including member and creditor protections which the rather idiosyncratic business organisations traditionally deal with when facing financial difficulties.<sup>72</sup> It is arguably the case, however, that those creditors who shout loudest will be accommodated at the expense of the minority interests, especially given that the priority of repayment structure tends only to activate on insolvency, not financial distress.

Nelson and Negm describe the process as a “disorderly collection of debts resulting in some creditors being paid but others missing out entirely”, which undermines survival prospects and encourages the filtering of assets into hiding.<sup>73</sup> There was negligible judicial oversight of the negotiation process before the BL 2018 and this deprived the judiciary of the opportunity to develop a depth of commercial and market awareness to facilitate the culture of rescue. The greater risk of loss must therefore fall upon minority debtors which increases the likelihood of dissent in the face of a more formal proposed settlement arrangement, even though the observance of *Shari’a* demands full recompense.

Corporate law and the issue of proceedings concerning financial distress, debt and bankruptcy, jurisdiction falls, as per Article 35 of the Law of Procedure before *Shari’a* Courts 2013, under the regional commercial courts. Their task is to resolve disputes between partners in partnerships and lawsuits of bankruptcy and impose an interdiction on bankrupt persons and removal thereof.<sup>74</sup> Three conditions have to be satisfied for the court panel to oversee and adjudicate on corporate applications and actions: (i) the defendant must be a person who engages in business activity as per Article 1 of the Commercial Courts Law 1970 (CCL 1970);<sup>75</sup> (ii)

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<sup>71</sup> CMA, ‘Capital Market Authority of Saudi Arabia’ <<https://cma.org.sa/en/AboutCMA/Pages/AboutCMA.aspx>> accessed 20 September 2019.

<sup>72</sup> Qaisar A Malik, ‘Idiosyncratic Effect of Corporate Solvency Management Strategies on Corporate Performance Valuation – A Study of Chemical Industry’ (2013) 10(2) IOSR Journal of Business and Management 49.

<sup>73</sup> Nelson and Negm (n 4).

<sup>74</sup> Royal Decree No M/1 of 22/01/1435 (25/11/2013).

<sup>75</sup> Royal Decree No M/2 of 15/1/1390 (23/03/1970).

the dispute must be a commercial matter arising from such activity of the defendant as per Article 2; and (iii) there must be no other applicable appropriate jurisdiction, for example, under other regulatory provisions. The company law jurisdiction needed to expand its application and introduce more effective, simpler, predictable and encompassing procedures to meet international and private business demands. The economy had to develop greater facilitation of private enterprise needs to develop entrepreneurship and attractiveness to international business.

Increased protections are given to minority dissenting creditors in the BL 2018, especially where the court is dissatisfied with compliance with the formal legal disclosure procedure, as occurred with Ahmad Hamad Algozaibi and Brothers.<sup>76</sup> Clearly steps have been taken to remedy the absence of transparency in the civil law procedure. The cram-down of minority interests which seek to frustrate a potentially effective rescue procedure is facilitated by the BL 2018, in a manner where such rights were not protected under the SABL 1996, but it must comply with the stricture of the *Shari'a* compliant demands of openness and probity. The judges now have a clear framework within which to exercise their discretion and skills of evaluation of fairness and reasonableness which was not available in the operation of the 1996 legislation.

#### 4.2.3. 'New' Legislative Framework

The corporate legal framework in the KSA continues to undergo substantial change by creating a company restructuring scheme consistent with the frameworks in industrialised nations that is commensurate with the modernisation process of the Saudi Vision 2030 initiative. A core objective of the Vision is to liberalise international trade with the KSA and increase investment therein through the reform of outdated, internationally uncompetitive and unattractive corporate laws.<sup>77</sup> The Gulf International Bank's Assessment of the NTP 2020 noted that the

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<sup>76</sup> Davide Barbuscia and Marwa Rashad, 'Saudi Court Rejects AHAB's Filing Under Bankruptcy Law' (Reuters Financials, 13 February 2019) <<https://www.reuters.com/article/saudi-debt-ahab/saudi-court-rejects-ahabs-filing-under-bankruptcy-law-idUSL5N20854C>> accessed 20 September 2019.

<sup>77</sup> The Vision 2030 (n 2).

KSA's "track record in implementing structural reform has been weak in spite of numerous ambitious announcements and plans".<sup>78</sup>

Economic challenges arising from the finite and volatile nature of the basis of the Kingdom's wealth necessitated the development of a new and diverse international economy.<sup>79</sup> Accordingly, the Ministry of Commerce and Investment was tasked with reviewing the corporate law framework and identifying areas requiring urgent reform in the country's legislative environment.<sup>80</sup> Following the announcement of Vision 2030 in 2016, the Ministry confirmed that the BL 2018 would substantially repeal and replace the provisions of the SABL 1996 and Chapter 10 of the CCL 1931 that were retained after the 1996 legislation.

The assistance of legal experts and consultants drawn from the United Nations Commission on International Trade Law (UNCITRAL), the World Bank, the International Monetary Fund (IMF) and other international trade organisations underpinned the Vision 2030 path to law reform. Their advice was predicated on utilising the most commercially attractive bankruptcy provisions of acknowledged international specialists in the field of international corporate finance and services.<sup>81</sup> Transplantation of a legal framework from one jurisdiction to another is arguably a haphazard way of developing a system of law and carries considerable risk of failure.<sup>82</sup> The new law is essentially a formalised collection of customs and norms exported from other nations and cultures<sup>83</sup> but adapted to the religious and values foundations of Saudi Arabia.

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<sup>78</sup> Rima Bhatia, 'Assessment of the National Transformation Program' (Gulf's International Bank 2016) 10 <[https://www.gib.com/sites/default/files/ntp\\_ebook\\_-\\_final\\_12\\_-\\_low-res\\_0\\_0\\_4.pdf](https://www.gib.com/sites/default/files/ntp_ebook_-_final_12_-_low-res_0_0_4.pdf)> accessed 20 September 2019.

<sup>79</sup> Waheed Banafea and Abdullah Ibnrubbian, 'Assessment of Economic Diversification in Saudi Arabia through Nine Development Plan' (2018) 42(1) OPEC Energy Review 42.

<sup>80</sup> Nelson and Negm (n 4).

<sup>81</sup> Dario Najm, 'Commentary on the Saudi Arabian Bankruptcy Law' (LNB News 5 July 2018) <[https://www.bsabh.com/wp-content/uploads/2018/07/Commentary\\_on\\_the\\_Saudi\\_Arabian\\_Bankruptcy\\_Law\\_Dario-Najm.pdf](https://www.bsabh.com/wp-content/uploads/2018/07/Commentary_on_the_Saudi_Arabian_Bankruptcy_Law_Dario-Najm.pdf)> accessed 20 September 2019.

<sup>82</sup> Rosaline Baidu Cowan, 'The Effect of Transplanting Legislation from One Jurisdiction to Another' (2013) 39(3) Commonwealth Law Bulletin 479.

<sup>83</sup> Jean-Louis Halperin, 'The Concept of Law: A Western Transplant?' (2009) 10(2) Theoretical Inquiries in Law 333.



The legislative change was initiated on 13 February 2018 when King Salman approved the Royal Decree on bankruptcy and other insolvency procedures and solutions.<sup>84</sup> Published in *Um Al-Quraa*, the country's official gazette, the BL 2018 will come into effect in August 2018 by which time secondary legislation and regulations had been drafted to provide operational efficacy.<sup>85</sup> The BL 2018 applies to individuals and corporations that carry on commercial, professional and for-profit businesses in the KSA and non-Saudi investors with assets in the country or that conduct business through another party in the country.<sup>86</sup>

It is argued that the KSA has not simply transplanted legal methods from other jurisdictions and then sought to adapt them to its own cultural imperatives. In fact, it has sought advice on structural reform and adopted in the BL 2018 principles entirely compatible with *Shari'a*. Examples are the protection of minority interests, promotion of rescue to facilitate future payment of debt, application of a moratorium to allow breathing space for the distressed, and ensuring that *riba* does not exacerbate encumbrances of already struggling businesses. Similarity is not indicative of transplantation, simply a recognition of standards which have proved effective across the global jurisdictions.

The accumulation of knowledge and advice should not be interpreted as the KSA needing to learn the effective ways of others on matters of law and corporate conduct requirements. In the context of the protection of minority shareholder interests in business, for example, the World Bank assessed the Kingdom to be in the global top 10 of nations before bankruptcy law reform, also scoring highly in the resolution of conflict of interests' index.<sup>87</sup> More effective government regulation enabled greater clarification and registering procedures of corporate control structures, facilitating improved transparency and disclosure. Herein lies the underlying

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<sup>84</sup> Royal Decree No M/05 (n 1).

<sup>85</sup> Abdulaziz Albosaily and others, 'New Bankruptcy Law in the Kingdom of Saudi Arabia' (Clyde & Co 26 February 2018) <<https://www.clydeco.com/insight/article/new-bankruptcy-law-in-the-kingdom-of-saudi-arabia>> accessed 20 September 2019.

<sup>86</sup> Nelson and Negm (n 4).

<sup>87</sup> Ashraf Al-Saeed, 'Saudi Arabia Carries out Record Number of Reforms to Improve Business Climate: Doing Business Report' (The World Bank, Press Release October 2017) <<https://www.worldbank.org/en/news/press-release/2017/10/31/saudi-arabia-carries-out-record-number-of-reforms-to-improve-business-climate-doing-business-report>> accessed 20 September 2019.

motivation for corporate restructure and arrangement of undertakings, the rescue of a company as a going concern, and the avoidance of the socio-economic impact of its demise on the KSA. This strategy is expected not only to attract new commercial investment but also market the nation as a competitive provider of flexible legal services to international commerce.

Sight should not be lost of the practical role of corruption and bribery in corporate start-ups, rescue and survival, be it of government officials or creditors, in spite of the prohibitions of the Islamic principles which underpin the law. However, the authorities recognised the need for further corporate reform and action to seek elimination of corrupt practices by introducing transparent oversight of government procurement by protections offered to ‘whistle-blowers’ and the demand of asset declaration by officials.<sup>88</sup> This oversight and new powers to tackle corruption further applies to private corporate bodies. For example, the personal and corporate assets of Maan al-Sanea, formerly one of the richest men in the world, and his failed Saad Group were seized by the government and auctioned to pay creditors.<sup>89</sup> His prime position in the litany of Saudi corporate disasters which arose under the operation of the pre-2018 legislative reform is noted as markedly more serious compared to the group of Saudi businessmen held on charges of corruption charges in 2017, although both revolve around investor concerns about corporate governance.<sup>90</sup> Lassoued et al assert that “the extent and boldness of the recent measures taken in the KSA are indicative of the government’s resolve to eliminate corruption in the system”.<sup>91</sup> Although not forming a specific part of the new law, government action in enforcing existing penalties complement the transparency approach of

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<sup>88</sup> Middle East and Central Asia Department at the IMF, ‘Saudi Arabia: 2018 Article IV Consultation-Press Release and Staff Report’ (International Monetary Fund 2018) 21  
<<https://www.imf.org/en/Publications/CR/Issues/2018/08/24/Saudi-Arabia-2018-Article-IV-Consultation-Press-Release-and-Staff-Report-46195>> accessed 20 September 2019.

<sup>89</sup> Marwa Rashad and Stephen Kalin, ‘Auction of Detained Saudi Tycoon’s Properties to Start Dec 2 – Sources’ (Reuters 23 November 2018) <<https://www.reuters.com/article/saudi-debt-restructuring/auction-of-detained-saudi-tycoons-properties-to-start-dec-2-sources-idUSL8N1XH7SW>> accessed 20 September 2019.

<sup>90</sup> *ibid.*

<sup>91</sup> Ibtissem Lassoued, Saeed Alqahtani and Abdullah Alabdali, ‘Saudi Arabia: The Calm After the Storm: Saudi Arabia’s Anti-Corruption Tornado and the Investor Impact’ (Altamimi & Co 9 August 2018)  
<<http://www.mondaq.com/saudiarabia/x/726614/White+Collar+Crime+Fraud/The+Calm+After+The+Storm+Saudi+Arabias+AntiCorruption+Tornado+And+The+Investor+Impact>> accessed 20 September 2019.

corporates to creditor, investor and shareholder rights and interests in times of financial difficulty and when there is a need for rescue.

### **4.3. Review of Key Provisions on Corporate Restructuring**

The BL 2018 is substantial, comprising 17 chapters which incorporate 231 articles focusing on (i) liquidation procedures, (ii) financial reorganisation and (iii) preventive settlement.<sup>92</sup> A key feature of the liquidation procedures is that an order by the Bankruptcy Committee for the liquidation of the assets of a bankrupt debtor is a last resort.<sup>93</sup> The emphasis of the legislation is therefore on corporate rescue – the goal of international schemes of arrangement. In order to facilitate the restructure planning, Article 46 enables the suspension of claims up to the date of the Court’s rejection of the petition to open the proceedings, acceptance of the proposal or earlier termination of the proceedings.<sup>94</sup> This moratorium gives respite, breathing space, whilst obligations are rearranged with a view to fulfilment.

Restructuring of liabilities and debt is geared toward addressing financial distress where companies face having to breach obligations to creditors set out in formal agreements between the parties. The purpose is to achieve a compromise which enables corporations to continue with operations whilst servicing debts.<sup>95</sup> The aim of preventive settlement provisions is to pull the company back from its imminent demise, within which bankruptcy beneficiaries develop a court-supervised arrangement to attempt rescue.<sup>96</sup> The focus of the law is evidently on rescue from insolvency or financial distress. Nevertheless, simply because insolvency proceedings have commenced does not exclude the potential for rehabilitating the company by a scheme or indeed rescuing the business itself as a going concern.<sup>97</sup> With a carefully negotiated, fair,

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<sup>92</sup> Albosaily and others (n 85).

<sup>93</sup> Zahi Y Younes, ‘Saudi Arabia Issues its First Developed Bankruptcy Law’ (Baker McKenzie 5 March 2018) <<https://www.bakermckenzie.com/en/insight/publications/2018/03/saudi-arabia-first-developed-bankruptcy-law>> accessed 20 September 2019.

<sup>94</sup> Royal Decree No M/05 (n 1).

<sup>95</sup> Younes (n 93).

<sup>96</sup> *ibid.*

<sup>97</sup> David Milman, ‘Corporate Governance and the Distressed Firm under English Law in the Wake of the Global Financial Crisis’ (Workshop on Post-crisis Trajectories of European Corporate Governance: Dealing with the Present and Building the Future, University of Leeds 21 September 2012).

reasonable and flexible plan of action, the company can survive, meet its obligations to members, creditors, local stakeholders and the national economy, and avoid the social consequences of liquidation and the loss of operation.<sup>98</sup>

In business, however, nothing guarantees success, exemplified by the demise of the Saad Group, run by Maan al-Sanea, closely associated with the Ahmad Hamad al-Gosaibi and Brothers conglomerate.<sup>99</sup> Both have fought for survival in a mire of debt for a decade, using the former methods of negotiation and attempted settlement, and from August 2018 with the BL 2018 until the court could supervise a more orderly breakup of the empires having eased the course to liquidation through the failed rescue schemes. Although the first major foray of the KSA courts into the scheme of arrangement, company rescue and organising demise involved conglomerates which appear beyond rehabilitation, the management by the judiciary in the strict interpretation of the civil law bodes well for the commercial future of the New Law. Financial distress is a national growth opportunity for financial services, domestic firms, foreign international lawyers. Indeed, venture capital funds with experience of 'turning around' failing companies are a new development in the Saudi economy, with 'new' owners turning around the financial failings of corporations with a view to managing or selling them on as a new viable business.<sup>100</sup> Venture capitalism is a relatively new Saudi market which requires examination to ensure compliance with *Shari'a* demands and duties of debtors and creditors.

Accessibility of the law attracts companies to the KSA to recuperate and restructure before re-entering the world economy as a new, revitalised entity.<sup>101</sup> It is only when it cannot continue as a going concern that the BL 2018 will manage its liquidation and the sale of its assets. It is

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<sup>98</sup> Royal Decree No M/05 (n 1) art 47.

<sup>99</sup> Marwa Rashad and Davide Barbuscia, 'Exclusive: Saad Group Seeks Debt Resolution under Saudi Bankruptcy Law – Sources' (Reuters 18 February 2019) <<https://www.reuters.com/article/us-saudi-debt-restructuring-exclusive/exclusive-saad-group-seeks-debt-resolution-under-saudi-bankruptcy-law-sources-idUSKCN1Q71HV>> accessed 20 September 2019.

<sup>100</sup> Martin Creek, 'Venture Capital Investment in Saudi Arabia: Market and Regulatory Overview' (*Zamakhchary and Co*, 2017).

<sup>101</sup> Tom Arnold, 'In Boost to Reform, Saudi Arabia's Cabinet Approves Bankruptcy Law' (Reuters 8 February 2018) <<https://www.reuters.com/article/us-saudi-bankruptcy/in-boost-to-reform-saudi-arabias-cabinet-approves-bankruptcy-law-idUSKCN1G20PJ>> accessed 20 September 2019.

pertinent to note that reference to creditors and debtors throughout the legislation suggests that the law limits its application to situations of financial distress and, as such, companies may not be able to use its procedures as a more general restructuring tool.

The focus is on common contexts experienced by corporate enterprises, the first arising where the debtor has not yet reached the stage of considering the necessity of bankruptcy but suffers illiquidity and financial distress. The debtor company will continue to manage its own affairs as long as the liabilities continue to be discharged, albeit following an application to the court, under the supervision of a trustee and the noted interdictions.<sup>102</sup> The next step in the path of the increasing distress is that the debtor may be experiencing insolvency in the failure to discharge liabilities. The court will consider intervention and taking over management until such time as the company is rescued or falls into bankruptcy.<sup>103</sup> Given that rescue is the priority of the legislation, new management will seek financial reorganisation or preventive settlement with creditors. Only on the failure of such an arrangement will the court institute liquidation and distribution.<sup>104</sup>

The circumstances of financial distress, recovery, rescue and bankruptcy are considered on a case-by-case basis; every business organisation has different needs and prospects, and indeed there are diverse interests and rights put at risk by failure. Corporate restructure under the BL 2018 is not so much capital repayment to investor-shareholders but the overriding principle of protection of the creditors in the event of company liquidation and a just and fair distribution of remaining assets.<sup>105</sup> The directors of the debtor company remain in place. They are in perhaps the best position to know what the particular corporate needs are, with court oversight and monitoring of their conduct.

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<sup>102</sup> Royal Decree No M/05 (n 1) art 69.

<sup>103</sup> Abdulmajeed Almansour, 'Jurisprudence Adaptation of the New Bankruptcy Law Procedures' (The Research Excellence in Contemporary Jurisprudence Centre at IMAMU 2018)  
<<https://units.imamu.edu.sa/rcentres/rces/fileslibrary/PublishingImages/Pages/default/تفليس%20الشركات%20ورقة%20عمل%20د%20عبد%20المجيد.pdf>> accessed 20 September 2019.

<sup>104</sup> *ibid.*

<sup>105</sup> *ibid.*

The principle of director responsibility for the management of corporate assets is based on the effect of *Shari'a* on the civil law. This provides 'encouragement' in the face of personal liability risk whilst still maintaining discretion in the exercise of decision-making in the market.<sup>106</sup> Codification of director duties under the Companies Law 2015<sup>107</sup> (CL 2015) imposes civil duties commensurate with the UK Companies Act, including penalties for breach.<sup>108</sup> The codification of the corporate law provides clear expectations for directors in the exercise of their fiduciary duties to the company, its shareholders and creditors, including honesty, avoidance of conflict and even 'errors of management' subject to potentially severe penalties.<sup>109</sup> There is, however, little jurisprudence under the CL 2015 to indicate how the penalties have operated in practice given the lack of court reporting, especially regarding Articles 211 and 212 which provide for incarceration of up to 5 years and the imposition of significant fines in addition to the repayment of any gains from misconduct.

In order to achieve fair asset distribution following the failure of reasonable prospects to rescue, the directors will be made subject to a diverse range of restrictions and prohibitions pending adjudication of degree of fault. These include personal travel restrictions on the person who is adjudicated bankrupt, and prevention of disposal of property and of moving address; all of these are within the jurisdiction of the commercial court judge.<sup>110</sup> Such restrictions on personal movement and freedom are unusual insofar as other jurisdictions examined, but perhaps reflective of the residual perception on attribution of personal blame for corporate failure. The distinction between corporate and individual bankruptcy arguably remains somewhat blurred by the application of the principle of personal responsibility and will require judicial application to better understand how the courts will ensure compatibility.

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<sup>106</sup> Bremer (n 46).

<sup>107</sup> Royal Decree No M/03 of 28/01/1437 (10/11/2015).

<sup>108</sup> *ibid.*

<sup>109</sup> Bremer (n 46).

<sup>110</sup> See Accounting and Auditing Organization for Islamic Financial Institutions, *Shariah Standards* (AAOIFI 2017) Standard No. 43 on Insolvency 1061-1074 <<http://aaoifi.com/shariaa-standards/?lang=en>> accessed 20 September 2019.

#### 4.3.1. Financial Reorganisation

The purpose of the BL 2018 is unequivocally stated in Article 1, which is to facilitate the conclusion of an agreement between the debtor and creditors on the financial reorganisation of the debtor activities under the supervision of the financial reorganisation trustee.<sup>111</sup> The BL 2018 uses the terms ‘financial reorganisation’ and ‘financial restructuring’ instead of corporate restructuring, which is defined by Article 2 as an arrangement or procedure in which the creditors and the debtor company agree to a reorganisation of the debtor’s debt obligations under the supervision of a licensed bankruptcy trustee.<sup>112</sup> The supervisory role of what is essentially a court agent is carried over from the 1965 legislation and is central to the oversight of the probity of the new process.<sup>113</sup> However, the limiting of liability continues to pose some conflict of personal responsibility for debt repayment with the purpose of encouraging entrepreneurship and shareholder investment. The BL 2018 lacks clarity in addressing the treatment of company debt in the context of liability of the shareholders and directors. This appears to reassert the principle of the corporate veil and avoidance of personal liability for one’s own actions which conflict with *Shari’a*.<sup>114</sup>

To be precise, Article 181 CL 2015 states that:

“... if the losses of a limited liability company amount to half its capital, the company’s directors shall record such incidents in the commercial register and call the partners for a meeting within 90 days from the date of becoming aware of such losses to consider continuation or dissolution of the company.”<sup>115</sup>

The relatively harsh sanction for failure to call a shareholders’ meeting is the dissolution of the company and directors’ personal liability, and is predicated on the interpretation of what constitutes ‘awareness’.<sup>116</sup> This is arguably a subjective assessment based on directors’

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<sup>111</sup> Royal Decree No M/05 (n 1) part 1.

<sup>112</sup> *ibid* art 2.

<sup>113</sup> *ibid* arts 50-57.

<sup>114</sup> Aljasir (n 51).

<sup>115</sup> Royal Decree No M/03 (n 107).

<sup>116</sup> Hala Bakhsh, ‘KSA: Supporting Companies in Accordance to the New Companies Law’ (Altamimi & Co March 2018) <<https://www.tamimi.com/law-update-articles/ksa-supporting-companies-in-accordance-to-the-new-companies-law/>> accessed 20 September 2019.

discretion in exercising their governance duties of corporate supervision. Objectivity does not conceptually lend itself to proof of actual knowledge of decline, but it has not been possible to ascertain a legislative standard or level set in the Governance Rules nor in jurisprudence which clarifies the basis of 'being aware'.<sup>117</sup> Article 30/17 of the Corporate Governance Regulations 2017 simply requires directors to keep shareholders informed and act "on the basis of complete information, in good faith and with the necessary care and diligence for the interests of the company and all shareholders".<sup>118</sup>

Nevertheless, such losses serve as a warning of problems with company finances and the question of continuance or bankruptcy to creditors and other stakeholders, certainly following its publication in accordance with Article 158 of the CL 2015. The major interpretive and practical problem arises with the provision which states that "the company shall be deemed terminated by the force of law if the company's directors fail to call the partners to a meeting or if the partners fail to issue a decision relating to the company's continuation or dissolution".<sup>119</sup> This appears a rather crude enforcement of a corporate governance principle and duty to act in the best interests of the company. Indeed, it seems contrary to the legislative focus on rescue and continuance.

This leaves the directors in a position of potential personal responsibility and sanction as outlined above; the contract is voidable as an act of wrongful trading when the threat to company survival is clear, as per Articles 78(1) and 165(2) of the CL 2015. It will also have repercussions for enforcement of creditors and other stakeholder interests, especially if this should arise post-preventive intervention as a result of its failure. Lack of cooperation from management will cause considerable personal sanctions for the directors, but in the round will give greater clarification and guidance on the implementation and effect of Article 181 from the legislative and regulatory bodies.

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<sup>117</sup> Khalid Saad Alhabshan, 'Current Practices and Improvement of Saudi Corporate Governance Framework' (2017) 10(4) *Journal of Politics and Law* 1.

<sup>118</sup> Corporate Governance Regulations 16/5/1438 (13/2/2017), art 30/17.

<sup>119</sup> Royal Decree No M/03 (n 107). art 181(3).



What follows is a largely narrative review and statement of the BL 2018 to demonstrate its operation. Commentary is somewhat limited because the BL 2018 has not yet achieved any contextual, case-related conclusion given its novelty.

An application is made to the Commercial Court under Article 42 provided that the company has not taken the opportunity to do so on a previous occasion of distress. The Article specifies that: the debtor, creditor or department concerned may petition the Court to open financial reorganisation proceedings of the debtor where financial distress which may lead to insolvency is anticipated or the company is bankrupt. The 'court' referred to is the Commercial Court, established in 2007<sup>120</sup> with a view to ensuring a trained and expert judiciary which deals only with corporate law. Judicial expertise has developed considerably in the last decade as a result of increasing specialisation of its work in the intervening years, with plans for enhanced training in place.<sup>121</sup>

Creditors may also make such an application upon giving notice to the indebted corporation within five days thereof to allow the company to object. However, this creditor request may be challenged under Article 44 under which the company debtor can argue that (i) the issue raised is outside the scope of financial reorganisation, (ii) the debt which is the subject of the application is in dispute, and (iii) the creditor's request amounts to an abuse of its rights. In order to draw the court into involvement and adjudication of the arrangements, the creditor must therefore prove their justification, a lack of fair treatment or a loss of rights or prejudice. Given the purpose and rescue focus of the legislation, where the application is simply to pursue liquidation and realisation of assets, it will be refused.

The arrangement for financial reorganisation of a company near or in liquidation status will generally lead to the compromise of its capital structure. It will be placed under the control of an administrator until such time as a rescue plan is conceived. It will therefore exclude

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<sup>120</sup> Royal Decree No M/87 (n 38).

<sup>121</sup> Andrew Torchia, 'Saudi Arabia's Legal Revamp Offers Hope for Cautious Investors' (Reuters 27 September 2018) <<https://www.reuters.com/article/us-saudi-economy-court-analysis/saudi-arabias-legal-revamp-offers-hope-for-cautious-investors-idUSKCN1M7157>> accessed 20 September 2019.

company auditors, board members, managers, shareholders and debtors from the CL 2015 process as soon as the value of its total capital falls below 50%.<sup>122</sup> Article 45 thus suggests restrictions are placed on directors and shareholders when the capital base has become seriously and so obviously debilitated.

It is as yet unclear whether the limitations placed on pursuit of the rescue process of the law require a suspicion of wrongdoing and resultant damage, and what alternative intervention mechanisms are implemented. It is necessary to await the court's interpretation of that provision which effectively appears to halt the operation of the process. The court will, for example, reject a petition to reorganise (i) if the petition does not satisfy legal requirements or is found to be incomplete without acceptable justification, and (ii) if the petitioner acts in bad intent or commits any of the acts criminalised by the Law, whereupon the court may open bankruptcy proceedings.<sup>123</sup>

All documentation requested by the court regarding accounts and liabilities must be disclosed to the court within twenty-one days to facilitate consideration of acceptance or rejection,<sup>124</sup> where necessary through use of the power to summon witnesses the judge believes has pertinent information of the financial state of the company.<sup>125</sup> The reorganisation process commences on approval by the court of the company's, or creditor's, request with the judicial appointment of a licensed bankruptcy trustee who will exercise due diligence and care in administering the interests of creditors.<sup>126</sup> The trustee, who is charged to act with due care in the best interest of creditors and with the prior consent of the Court, may delegate some of his functions to a listed trustee or expert to perform those functions if required. The delegated functions shall be accurately and carefully described in the Court's decision.<sup>127</sup> Supervision may

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<sup>122</sup> Royal Decree No M/05 (n 1) art 45.

<sup>123</sup> *ibid* art 47(2/B).

<sup>124</sup> *ibid* art 47(2/G).

<sup>125</sup> *ibid* art 48.

<sup>126</sup> *ibid* art 50.

<sup>127</sup> *ibid* art 50(3&4).

also be undertaken by a court appointed, specific judge to whom the trustee will be answerable.<sup>128</sup>

Nevertheless, the trustee will not normally undertake the continued operation of the company business during the reorganisation process. Article 69(1) stipulates that, “without prejudice to the trustee’s authority and functions, the debtor shall continue to manage their business and activity throughout the financial reorganisation proceedings under the trustee’s supervision”. This is reflective of the US Bankruptcy Code Chapter 11 which envisages the debtor company’s management, those who were in control when the financial distress conditions arose, remain to conduct the ‘ordinary course of business’, albeit monitored by the US Trustee’s Office.<sup>129</sup> This ensures continuity through the use of directors’ institutional and market knowledge but would not, of course, include selling off assets.

That oversight should be intensive, given the need to enforce probity of company actions and behaviour. In the event of negligence or mismanagement, the director may be replaced, the operations halted and the company dissolved.<sup>130</sup> The role of the trustee is to conduct the essential notification and information gathering procedures through liaison with the creditors, ensuring the debtor company acts with justice and fairness in the protection of creditor interests.<sup>131</sup> This provides considerable authority to the trustee to demand disclosure and examine the intricate details of corporate financial management, reporting to the court given that Article 69 further imposes a fiduciary duty on the protection of creditor interests.

It is as yet unclear what consequences may arise in the event of a complaint by a creditor who believes his interests are undermined or inadequately protected. Case law is awaited to ascertain how the civil process, especially under Article 61, continues to be influenced by *Shari’a*, and whether reorganisation and administrative oversight authority brings freedom from obligations, and thus loss to creditors, or simply a delay in the satisfaction of obligations.

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<sup>128</sup> *ibid* art 53.

<sup>129</sup> Nathalie Martin, *Inside Bankruptcy: What Matters and Why* (Wolters Kluwer 2011) 223.

<sup>130</sup> Royal Decree No M/05 (n 1) art 69(2).

<sup>131</sup> *ibid* arts 56-59.

The BL 2018 is unlikely to allow the idiosyncratic administration of assets at the whim of directors, given the increased formal supervision powers of the court. In the AHAB insolvency, the operation of the disclosure and governance demands led the courts to exercise their discretion to refuse plans where effective due diligence had not been accorded to the fulfilment of transparency requirements.<sup>132</sup> The BL 2018 enabled the court to exercise control over the claims, using the cram-down procedure of the protective settlement process to prevent minority creditors inhibiting the conclusion of a decade long dispute.<sup>133</sup> Cram-down of interests, for the sake of clarification, does not exclude rights but simply stops the holders from frustrating the settlement process. Simon Charlton, who was responsible for the restructure of AHAB, noted that: “Failing to complete a settlement in a fair manner will be harmful to the interests of the vast majority of the creditors who wish to reach an agreement.”<sup>134</sup>

In the event of being permitted to continue operation during financial reorganisation, the distressed or bankrupt corporation is prohibited from engaging in activities that are outside the scope of its ordinary course of business.<sup>135</sup> Any such actions are invalid as they are contrary to the interests of shareholders and creditors under the plan. This is simply an extension of corporate governance principles – the demand that directors act within the constitution of the corporation – which is now effectively supervised through the extensive powers of review afforded to the trustee. An objective of the financial reorganisation arrangement is to serve the interests of the creditors whilst seeking the continuation of the company potentially conflicting with the company’s principle desire to structure a more manageable financial base of operation.

Such management as is permitted to remain or be put in place must make full disclosure of all contractual liabilities and obligations to the trustee, detailing what it believes are essential to

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<sup>132</sup> Gulf Business, ‘Saudi Court Rejects Conglomerate AHAB’s Filing under Bankruptcy Law’ (Gulf Business 16 February 2019) <<https://gulfbusiness.com/saudi-court-rejects-conglomerate-ahabs-filing-bankruptcy-law/>> accessed 20 September 2019.

<sup>133</sup> Barbuscia and Rashad (n 76).

<sup>134</sup> *ibid.*

<sup>135</sup> Royal Decree No M/05 (n 1) art 71.

the operation, and those to be renegotiated or terminated, with appropriate justifications.<sup>136</sup> This will enable the trustee to become, effectively, the conduit for negotiation whilst the management conduct the business activity of the company.<sup>137</sup> This includes dealing with premise leasing issues and the reorganisation of property agreements. There are important exemptions in the form of limitations to the trustee's authority, especially refinancing through banks and financial institutions.<sup>138</sup> These liabilities remain non-negotiable under the reorganisation process, although given their importance to the rescue prospects of the company there is likely be scope for non-legislatively binding rearrangements. Government contracts are also exempt from the provisions in Article 61. Where a contract party creditor might face perceived prejudice to interests in the reorganisation of debtor liabilities wishes to object, this is adjudicated upon by application to the commercial court. The trustee clearly has considerable powers to affect the financial entitlements and rights of creditors under the new legislation.

Should the directors wish to renew or issue a guarantee, execute a new insurance agreement, settle its debt obligations, or apply for or receive any form of financing, the approval of the trustee must be sought.<sup>139</sup> Indeed, the management must seek permission from the trustee to undertake most fundamental financial transactions on behalf of the debtor company. This includes the preparations for proposals requiring a creditor vote, vacating leased assets and entering into any lease contract which is necessary or beneficial for their activity and refinancing.<sup>140</sup> Prohibited disposals and financial transactions entered into without the consent of the trustee will be subject to revocation.<sup>141</sup>

In the light of the purpose of the legislation, a fiduciary duty lies between the trustee and creditors which *prima facie* inhibits or at least requires a sensitive balance to be struck with the rescue of the bankrupt company. The trustee is the final arbiter over all decisions on the future

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<sup>136</sup> *ibid* art 60(1).

<sup>137</sup> *ibid* art 61.

<sup>138</sup> *ibid* art 61(8).

<sup>139</sup> *ibid* art 70.

<sup>140</sup> *ibid* art 70(1).

<sup>141</sup> *ibid* art 71.

of the company in financial reorganisation, including on those which may alter or adjust the interests and rights of the creditors. The nature of the fiduciary duties and to whom they are owed is not codified in the CL 2015, and in any case is guided by the principles of *Shari'a* rather than legislation.<sup>142</sup> Where it is presumed that the trustee in bankruptcy essentially takes over obligations of the directors, the nature of the transparency, fairness and accountability applies not just to the company entity but to the shareholders and creditors. The process of recording and publicising judicial proceedings and adjudications by the newly established Bankruptcy Committee has not, it appears, become sufficiently operative to identify how the courts will consider the duties of the trustee who takes over the running of a company. This is an issue which will be monitored by the author for further study.

A Creditors' Committee will be formed in response to the petition for reorganisation being approved to proceed and on the appointment of the trustee.<sup>143</sup> The filing and listing of claims under Articles 63 and 68 along with supporting documentation essentially complements the trustee's duty to prepare a comprehensive inventory of company assets and valuations for presentation to the court.<sup>144</sup> This is generally expected within the first 14 days of the trustee's appointment indicative of the urgency of action. Failure of a creditor to submit a claim will lead to their exclusion from the negotiations.<sup>145</sup> Creditors will therefore find their interests best protected by involvement in the reorganisation process.

In the course of the reorganisation of liabilities, the trustee can, for example, veto an attempt by the corporation to settle a debt due to a creditor or a class that was not part of the restructuring agreement. This suggests that those not involved in the plan will effectively lose their entitlements, or certainly their potential priority. It is nevertheless subject to the approval of the court, not simply an arrangement between parties to exclude the enforcement of

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<sup>142</sup> Rashid O and Al-Abdulkareem K, 'LLC Directors in Saudi Arabia: Do they Have Fiduciary Duties?' (Practical Law 1 October 2014) <[https://uk.practicallaw.thomsonreuters.com/5-584-3347?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&comp=pluk&bhcp=1](https://uk.practicallaw.thomsonreuters.com/5-584-3347?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1)> accessed 20 September 2019.

<sup>143</sup> *ibid* art 73.

<sup>144</sup> *ibid* arts 65 & 66.

<sup>145</sup> *ibid* art 64.

inconvenient interests which remain subject to satisfaction through *Shari'a* principles dutifully observed by the judicial arbiter. They will have been given notice of the process and invited to submit any claims against the indebted corporation within 90 days, yet they need not do so and the court will not compel them.<sup>146</sup> The implication is that they would lose any potential entitlement in the emergent restructured company. That would be contrary to the principles of fairness and reasonableness, and indeed undermine international respect for the process. The trustee will accommodate their claims, although they would arguably lose the practical benefit of active participation in the procedure.

Once an arrangement or compromise is reached between the debtor-company and its creditors, the bankruptcy trustee will supervise the operation of the indebted corporation to ensure that it adheres to the terms of the reorganisation arrangement and protects the interests of all creditors. The bankruptcy trustee will review prior and new contracts, lease agreements and supply contracts entered into with third parties to determine whether their terms are consistent with the reorganisation agreement. If they are found in conflict, these would be terminated. An aggrieved corporation or individual will retain the right to seek compensation for financial losses directly attributed to the termination of any agreement made with the debtor-company before the trustee's intervention.<sup>147</sup>

On conclusion of the trustee's dealings and negotiations with the creditors, Article 75 requires the debtor company, with the trustee, to prepare the reorganisation plan that includes detailed proposals and agreements to be presented to the court for review and to arrange a creditor vote. This must include a full outline of the financial position of the company. The trustee will of course have to certify his opinion on the prospects of success of approval. The creditors with voting rights are informed of the details of the reorganisation plan for the company.<sup>148</sup> The quorum required for proceeding is set out in the Regulations which guides the voting process

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<sup>146</sup> Najm (n 81).

<sup>147</sup> Albosaily and others (n 85).

<sup>148</sup> Royal Decree No M/05 (n 1) art 77.

and whether a meeting is held, or voting is undertaken electronically.<sup>149</sup> The other provisions in the legislation describe the publishing and registering regulations.

#### 4.3.2. Preventive Settlement

As set out in Article 11, preventive settlement is a restructured debt arrangement between a financially distressed company and its creditors which permits the indebted corporation to reorganise its liabilities and obligations whilst continuing to operate its business. It is essentially, again, limited to situations of impending financial crisis for companies seeking to stave off the potential insolvency effects thereof. It is not a new restructuring tool but reforms and updates the SABL 1996. Application may be made by the company or a creditor to the courts to assist in adjudication on the reorganisation of liabilities to ensure a reliable repayment scheme, whether the debtor entity is seeking to pre-empt potential financial distress or is bankrupt.<sup>150</sup> Court approval will also lend credibility to the restructure which will aid acceptance and recognition in foreign jurisdictions in a manner that more informal arrangements would not.

The legislature recognised that there is a temptation to run to the court when finances get difficult so warned via Article 13 that any such request may be rejected if the debtor company has had the benefit of the scheme in the year before. The court is not to be used as a source of help in dealing with common creditor problems which arise in the normal course of business. It is also not to be used as a threat by either party to force compliance. The scheme is a debt management process and compromise, suspending the risks associated with enforcement whilst a programme is developed to allow the business more time to satisfy concerned stakeholders.

The Ahmad Hamad Algosaihi and Brothers multinational Conglomerate (AHAB), a global investment holding company with interests in a diverse range of industries from construction and energy to hospitality and transport, had the dubious honour of being the first to use the

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<sup>149</sup> *ibid* art 79.

<sup>150</sup> Albosaily and others (n 85).



new law.<sup>151</sup> It looked for the advantage in the protection afforded by the ‘settlement procedure’ which allows the company to continue its operation.<sup>152</sup> This reflects a priority in the new law to seek preservation of employee rights and jobs as well as promoting national interests and reputation. The corporation was allowed to continue to trade pending the final outcome of the arrangement approval process. Two-thirds by value of creditors are required to approve the deal of settlement, which is proposed at only around 10% of the total debt owed; the company achieved a headcount quorum of 70% but only just over 50% by debt value.<sup>153</sup> On 21 January 2019, however, the Commercial Court in Dammam rejected the settlement arrangement, not so much, it appears, on the basis of an insufficient vote quorum, but due to the inadequacy of information provided to the creditors.<sup>154</sup> The company successfully appealed, but this is a salutary lesson; vested commercial interests do not supersede the law. Eventually, the company applied for a Financial Reorganisation instead, and the court accepted the opening of the procedure.

Preventive settlement is a broad pre-emptive action tool or a potential recovery mechanism, depending on the level of corporate financial distress, aimed at protecting the creditor whilst facilitating the continuation of the business. This makes it an attractive option for companies, both national and global, to recover from difficulties whilst maintaining their reputation with current and future stakeholders. The procedure under Article 15 is simple and remarkably similar to the scheme of arrangement: the court sets a hearing date and notifies interested parties, the preventive settlement proposal is presented, and the creditors have time to review the terms and then return with their vote. The role of the court, as per Article 15, is to evaluate and determine: (i) the likelihood that the preventive settlement arrangement will result in the debtor company being able to settle its debts; (ii) whether the financially distressed or bankrupt

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<sup>151</sup> Tom Arnold, ‘Saudi’s AHAB Turns to New Bankruptcy Law to Settle with Creditors’ (Reuters Bankruptcy News, 3 December 2018) <<https://www.reuters.com/article/saudi-debt-ahab/saudis-ahab-turns-to-new-bankruptcy-law-to-settle-with-creditors-idUSL8N1Y7072>> accessed 20 September 2019.

<sup>152</sup> *ibid.*

<sup>153</sup> *ibid.*

<sup>154</sup> Barbuscia and Rashad (n 76).

debtor might indeed incur more financial liabilities after the execution of the arrangement; and (iii) the motive, reason and good faith of the company in making the request.

Where bankruptcy proceedings are in progress at the time of the settlement application, the debtor company will generally request suspension thereof to safeguard its guarantors, creditors, members and assets under Article 18. The company must convince the court of its assertion that the majority of creditors and shareholders will support the preventive settlement application, and thereafter the court will review the merits of the settlement proposal. A resultant suspension should not exceed 180 days, which protects the entitlement of creditors suffering default to enforce their interests should the settlement fail to be approved.<sup>155</sup> It has been noted that dissolution is the final resort but remains an option in the event of failure. Furthermore, acceptance by the court of the preventive settlement request will not undermine liability for agreements entered into between the financially distressed corporation and third parties, even those executed prior to the settlement grant.<sup>156</sup> This reflects the *Shari'a* principle of honouring obligations.

The preventive settlement arrangement will end if the court rejects the parties' request, be it on the basis that the company is not financially distressed or it is beyond rescue, the latter being an unlikely finding at an early stage given the purpose of the scheme. The court will not, it is argued, countenance acceptance of a settlement plan as a tactical manoeuvre by a solvent company to alter performance of its obligations. Cancellation will also be applied (i) if following implementation of the agreement programme the debtor corporation presents a detailed report to the court of satisfaction of the agreement objectives, or (ii) when the debtor submits a statement that it no longer needs to be considered a beneficiary of preventive settlement due to a positive turnaround in its economic fortunes and ability to settle its liabilities. It is anticipated, or at least hoped, that a reinvigorated company will emerge from discharging the agreement in those circumstances.

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<sup>155</sup> Royal Decree No M/05 (n 1) art 18.

<sup>156</sup> *ibid* arts 22 to 24.

#### 4.4. Analysis of the KSA Corporate Restructuring in Light of Shari'a

The IMF and World Bank have noted that the new BL 2018 and the schemes developed thereunder have drawn inspiration from the bankruptcy laws in the UK, the US, Singapore and Germany. It is, however, also a national legislative framework in a country fundamentally based on the observance of *Shari'a* which underpins all commercial and financial transactions in the KSA. It is the product of interaction of international practice and religious law. This is particularly pertinent given the prohibited nature of interest-based transactions of refinancing in *Shari'a* and traditional perceptions of debt obligation satisfaction.

##### 4.4.1. Controversies Surrounding Interest-Based Transactions under Shari'a

The availability of 'working capital' is the 'lifeblood' of any business.<sup>157</sup> Corporate volatility and adversity arises when there is an unstable financial base to the company which draws concern from existing creditors and potential future institutional investors which perceive a risk to returns.

A fundamental tenet of *Shari'a* is a prohibition on interest-based payment arrangements, *riba*, which is tantamount to trading two goods, similar in different quantities, where the increase in quantities does not amount to adequate compensation.<sup>158</sup> It is a complex idea, somewhat simplified by Alfattoub and others who quote Abu Ishaq: "every loan that is returned with an increase, or for which a profit is gained, is forbidden".<sup>159</sup> *Riba* is effectively classified as *riba al-nasi'a* – an unearned, unjustified increase in the interest which was lent, and *riba al-fadl* – a comparative excess on the value of what was given in a transaction.<sup>160</sup> *Riba* is expressly prohibited by the Holy Quran<sup>161</sup> and the Sunnah ('Way of Prophet Muhammad and his hadith,

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<sup>157</sup> Simon Calver, *Success the LOVEFilm Way: How to Grow a Fast Growth Business in Fast Changing Times* (John Wiley and Sons 2013) Ch 1.

<sup>158</sup> Umer Chapra, 'Why Has Islam Prohibited Interest? Rationale behind the Prohibition' in A Thomas (ed), *Interest in Islamic Economics: Understanding Riba* (Psychology Press 2006) 96.

<sup>159</sup> Ruba Alfattouh, Abdulkader Thomas and Najwa Abdel Hadi, '*Riba* in Lisan al Arab' in Abdulkader Thomas (ed), *Interest in Islamic Economics: Understanding Riba* (Psychology Press 2006) 10.

<sup>160</sup> Mahmoud El-Gamal, *Islamic Finance: Law, Economics and Practice* (Cambridge University Press 2006) 49.

<sup>161</sup> See Verses 3:130, 2:278, 4:161, 2:275 and 2:276 of the Holy Quran.

traditions and sayings'), wherein Ubada b al-Samit reported the Prophet as saying: "Gold is to be paid for by gold, silver by silver, wheat by wheat, barley by barley ... like for like and equal for equal, payment being made hand to hand. If these classes differ, then sell as you wish if payment is made hand to hand".<sup>162</sup> The essence of *riba* is not primarily the interest charged by the creditor to make the loan or arrangement but the profit he demands from the debtor's sales, the excess expected or the delay in payment from the exchange of property.<sup>163</sup>

Essentially, the emphasis is on social and public wellbeing rather than the individual. This explains the priority of the BL 2018 on the preservation of corporate enterprises, at least where the operation has a functional future. There is a well-founded argument in the fact that loss will occur in a corporate demise so the principle of creditor assistance will not only serve a social purpose but will also facilitate a share in success. Simply put, *riba* interest is of no financial value to creditors in corporate failure. In *Shari'a*, it has been noted that lending and repayment do not imbue money with any value beyond being a means to an end, the improvement of the person, society and, in this context, the role of the company in promoting the advancement thereof. Potential business failure, at least now, is not considered by the law as deserving of punishment but of understanding, with the duties imposed being those of patience and hard work to return to a position where obligations, towards all parties, can be satisfied.

The Permanent Committee for Scholarly Research and *Ifta* is unequivocal in its rejection of usury in trading gold and silver, effectively money, and wheat, barley, dates or salt for profiteering over and above their value where there is a direct hand to hand transaction.<sup>164</sup> Ubada b. al-Samit's hadith was quoted by the committee as using the phrase "equal for equal" in the context of *riba al-fadl*. The creditor will get back from the rearrangement what he put in originally.

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<sup>162</sup> Abdullah Saeed and Omar Salah, 'History of Sukuk: Pragmatic and Idealist Approaches to Structuring Sukuk' in Mohamed Ariff, Munawar Iqbal and Shamser Mohamad, *The Islamic Debt Market for Sukuk Securities: Theories and Practice of Profit Sharing Investment* (Edward Elgar 2013) 42, 47.

<sup>163</sup> *ibid*.

<sup>164</sup> Permanent Committee for Scholarly Research and *Ifta*, '*Riba Al-Nasi'ah*' (Thirty second question of Fatwa No 18612) part 13, 330 <<http://www.alifta.net/Fatawa/FatawaDetails.aspx?languagename=en&View=Page&PageID=4854&PageNo=1&BookID=7>> accessed 20 September 2019.

This raises questions about the operation of the *Shari'a* prohibitions on *riba* and the potential financial speculation in the repayment of foreign currency-based debts, given fluctuations in the international markets. The return on debt may therefore be greater than that advanced, the money becoming a traded commodity in itself and thus prohibited by *riba*, or the creditor may lose out due to currency falls. In *Lehman Brothers* unsecured debts valued in foreign currency were deemed to be repayable at the rate prevailing on the date of administration.<sup>165</sup> It is unclear how the KSA courts will ensure *Shari'a* compliant reimbursement in the administration of international restructures and insolvency because the BL 2018 has not yet been used on this specific issue. The issue will perhaps be clarified by the decisions in Saad and AHAB, but given the duration of these multinational conglomerates' issues with the law, little information or guidance is expected soon.

Adherence to *Shari'a* prohibits the creditor from seeking a better position or higher reward from the company by charging more in monetary terms for cooperation in a bankruptcy scheme; lending money for a return of more money is prohibited. It must be emphasised that this injunction applies only to a trade in money and the commodities specified in the hadith. A similar constraint is imposed on *riba al-nasi'a*, deferment of exchange, in this context, of money (rather than the other commodities expressly highlighted in the hadith) in which an increment or penalty is paid by the debtor for the delay.<sup>166</sup>

The new BL 2018 procedures will operate on the fundamentals of balance, fairness and the avoidance of taking advantage of vulnerable corporations. Nevertheless, interests in the assets and future of the company must be rearranged, restructured or divided in accordance with the creditor's stake in the organisation and the continuing commercial risk. By way of a common corporate restructure method, a creditor, for example, may opt to enter into a court-sanctioned compromise or arrangement in which he agrees to restructure the debt repayment

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<sup>165</sup> *Lehman Brothers Holdings Inc (Appellant) v The Joint Administrators of Lehman Brothers International (Europe) and others (Respondents)* [2017] UKSC 38, para 73 and seq.

<sup>166</sup> Joni Tamkin Borhan, 'Rationale and Consequences of the Prohibition of *Riba* in an Islamic Economic System' (2009) VIII(2) *Innovatio* 291, 292  
<[https://www.researchgate.net/publication/313798147\\_Rationale\\_and\\_Consequences\\_of\\_the\\_Prohibition\\_of\\_Riba\\_in\\_an\\_Islamic\\_Economic\\_System](https://www.researchgate.net/publication/313798147_Rationale_and_Consequences_of_the_Prohibition_of_Riba_in_an_Islamic_Economic_System)> accessed 20 September 2019.

schedule in exchange for a benefit in the form of shares or stock options.<sup>167</sup> This is a *Shari'a*-compliant transaction as stocks and shares are not considered money, gold, silver or the other classes specifically mentioned in the hadith above, and not therefore subject to the rules on *riba*.<sup>168</sup> Indeed, the taking of shares in return for, or reconstruction of, the creditor's investment, may exceed the monetary value of the conversion, although that hardly constitutes an unearned 'reward' for continued support given the risk of loss. It arguably puts the creditor in the position of a part owner, sharing profit and risk in rescue.

Further, such risk cannot be contextualised as compensation for delay in repayment of the original investment in a company which is effectively facing dissolution. It does not make for an attractive financial risk proposition for creditor-investors who are ostensibly in a weaker position in terms of recovery of debt than ordinary owner-shareholders. The share exchange option in a high-risk company arguably carries no more hazard to the investor-creditor than earlier, pre-restructure liquidation.

From a more altruistic point of view, Ariff suggests that such an exchange of delayed investment for shares in the emergent entity may be regarded as a form of charity,<sup>169</sup> although this is not a convincing argument in what is expected to be a mutually beneficial financial transaction. *Shari'a* encourages investors to circulate their wealth, enter into investments and generate profit from those investments.<sup>170</sup> It does, however, expect investors to generate the profit through trade and other activities rather than through lending money in a debt restructuring compromise.

The loan or variation of interest in the company has to constitute a commercial risk from assisting the corporation to survive, not simply involve speculation.<sup>171</sup> The return on investment is justified as a sharing of commercial risk between creditor and debtor before repayment or

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<sup>167</sup> Philip Wood, *Principles of International Insolvency* (Sweet & Maxwell 2007) para 20-037.

<sup>168</sup> Jaquir Iqbal, *Islamic Financial Management* (Global Vision Publishing House 2009) 103.

<sup>169</sup> Mohamed Ariff, *The Islamic Voluntary Sector in Southeast Asia* (Institute of Southeast Asian Studies 1991) 20.

<sup>170</sup> Mondher Bellalah, *Islamic Banking and Finance* (Cambridge Scholars 2013) 133.

<sup>171</sup> John D Finnerty, *Project Financing: Asset-based Financial Engineering* (Wiley 2013).

restitution is made.<sup>172</sup> The risk of non-repayment of a loan will not, per se, suffice as a 'faith loophole'; commercial risk is essentially becoming reliant on the company to succeed.

The profit-and-loss sharing of risk is a vital Islamic principle in financial transactions and corporate operations, particularly for a vibrant commercial SME structure encouraged by the KSA government.<sup>173</sup> Creditor investment is high risk in such enterprises, more so when liquidation restructure needs loom. Investors and financial service sector bodies have developed various profit-and-loss sharing models to accommodate religious demands to receive a just and reasonable return by way of a profit share for their commercial risk undertaking by agreement to aid the rescue programme.<sup>174</sup> The scheme must effectively constitute a business partnership, or ownership of risk, albeit the investor is unlikely to be integrally involved in its operation but injects funding or rearranges the nature of the interest in the company in exchange for a proportion of the profits from the restructured entity.<sup>175</sup> Where the agreed profit share on the reorganised holding falls short for the investor, the arrangement share, too, must correlate or fall foul of the *riba* prohibition; profit share proportions vary with degrees of success and corporation needs. A pre-specified profit return into the debt restructuring compromise would not be *Shari'a*-compliant.

Creditors must structure their expectation in a manner which will not exploit or increase the vulnerability of the company to liquidation and ensure mutual benefit to themselves and the company. Share and stock ownership provides a considerable incentive to encourage growth. It is not a speculative arrangement prohibited in *Shari'a*.<sup>176</sup> To share profit, creditor action must facilitate the growth of the company as it emerges from distress. The risk factor constitutes a transfer from current company indebtedness to that associated with the success or failure of the scheme targeted at restoring its fortunes.

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<sup>172</sup> Brian Kettell, *Frequently Asked Questions in Islamic Finance* (Wiley 2013).

<sup>173</sup> Alhanoof Alghamdi, 'The Viability of Profit-Loss Sharing Models to Finance Small and Medium Enterprises: The Case of Saudi Arabia' (University of Denver 2017) 1365.

<sup>174</sup> Saeed and Salah (n 162) 47.

<sup>175</sup> IBP Inc, *Investment Laws in Muslim Countries*, Volume 1 (Int'l Business Publications 2015) 72.

<sup>176</sup> *ibid* 71.

The return is not prohibited *riba*, that is, interest payable on a conventional money based loan, in a Saudi debt restructuring agreement but the charging and receipt of a percentage of the profit yielded from the entity or project which emerges from a debt restructuring compromise or the injected funds.<sup>177</sup> *Riba* prohibition does not prevent profit and risk sharing as a source of investment return provided money of itself is not used to generate profit for the creditor.<sup>178</sup> Monetary return is not profit simply because it carries the risk of non-payment.<sup>179</sup> It is simply an instrument of exchange that lacks an intrinsic value, used as a means to an end or of exchange, not an end in itself. In the context of debt restructuring and schemes of arrangement, *riba* is the use of money to generate money. Corporate rescue, complemented by rather exceptional commercial risk of ownership in the corporation, justifies investment return for preserving, for example, the diverse services of employment and social interaction for a community. .

#### 4.4.2. Bankruptcy and Debt Restructuring under *Shari'a*

Mutual benefit to creditors, debtors and stakeholder members must feature prominently in the *Shari'a* approach to managing debt restructuring and bankruptcy. The concept of *iflas* encompasses (i) 'balance sheet insolvency' where corporate assets are substantially less than the liabilities or (ii) 'income statement insolvency', inadequate cash flow liquidity or easily monetised assets to meet debt obligations.<sup>180</sup> Further, the term *mufliis* denotes a bankrupt corporation or individual who, under *Shari'a* principles, may only resolve that status and redeem itself through the full repayment of all its debt obligations, the death of the individual bankrupt or the dissolution of the company with the sale and distribution of its assets.<sup>181</sup>

The Quran, under Verse 2:280, advises creditors to give temporary respite to those undergoing financial constraints until financial stability has been restored. Therein lies the importance of a

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<sup>177</sup> Habib Ahmed, 'Insolvency and Debt Restructuring: Prevention is Better than Cure' (Harvard-LSE Workshop on Insolvency & Debt Restructuring in Islamic Finance 28 February 2013) <[http://irep.iium.edu.my/30475/1/Harvard-LSE\\_Workshop\\_Comments\\_Feb23.pdf](http://irep.iium.edu.my/30475/1/Harvard-LSE_Workshop_Comments_Feb23.pdf)> accessed 20 September 2019.

<sup>178</sup> Mahmoud El-Gamal, "'Interest' and the Paradox of Contemporary Islamic Law and Finance' (Rice University) 12 <<http://www.ruf.rice.edu/~elgamal/files/interest.pdf>> accessed 20 September 2019.

<sup>179</sup> Saeed and Salah (n 162) 48.

<sup>180</sup> Awad and Michael (n 30).

<sup>181</sup> *ibid.*



moratorium on potential legal actions for debt recovery which would inhibit the prospects of a secure financial future for the company through the restructure process. The charity and social responsibility of the creditor are called upon, which are key pillars of *Shari'a* in the bankruptcy context.

These are heavy demands made of creditors facing potentially debilitating losses. It is noted that charity and social responsibility appear as a form of religious appeal rather than a binding rule of practice in corporate financial distress situations, but compassion is moderated by Verse 5:1 which makes it a sin to fail to pay debts when financially stable.<sup>182</sup> The ultimate aim of the BL 2018, is the return of the company to profitability and its ability to discharge its liabilities. It is an exercise in patience, adjustment and understanding which form the basis of the preventive settlement and financial reorganisation processes of the legislation. Jurists have underscored this point by reminding Muslims about the Prophet's caution against the practice of delaying debt repayments without a reasonable excuse, which is unjust even when the creditor is a wealthy individual or corporation.<sup>183</sup> This warning has led jurists to argue that debt is an issue that companies must be wary of, bearing in mind that the souls of debtors will remain in limbo until the debt is paid.<sup>184</sup>

*Shari'a* has evidently influenced the provisions and operation of legislation, imposing duties on the parties managing financial distress, although the legal pain of non-compliance with the law is somewhat less intimidating than suffering the wrath promised in the Quran and Sunnah. This may hold little concern for secular, profit-orientated business entities with nothing other than a monetary return stake, but there is nothing inherent in the principles of the legislation which are unattractive. The focus and methods of achieving salvation from demise aim for a credible

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<sup>182</sup> *ibid.*

<sup>183</sup> Muhammad Yusuf Saleem, *Islamic Commercial Law* (John Wiley and Sons 2012) Ch 5: The Contract of Loan.

<sup>184</sup> Nadeem Walayat, 'Ramadan Diaries - Islam, Muslims and the Haram Benefits Culture' (The Market Oracle 27 July 2013) <<http://www.marketoracle.co.uk/Article41596.html>> accessed 20 September 2019.

balance of patience, cooperation, compromise and reward – all of which are philosophical principles which correlate with the wider socio-economic need for a thriving corporate law.<sup>185</sup>

The prohibition of *riba* is a lesson to creditors and companies on the approach required by the law to the principle of reorganisation of assets and liabilities, which is to share in the success and failure whilst avoiding unjustified and unearned rewards.<sup>186</sup> There is no *riba* prohibition on the exchange of money for shares. This may give negotiating strength to creditors to increase their stake in the business and a reward through the success of the company, but it is a commercial risk which is as likely to lead to loss. Other implorations of *Shari'a*, such as for patience, compassion and the payment of debt, follow in the footsteps of *riba* prohibitions, and particularly where the exchange does not involve the hadith commodities outlined.

This study does not consider mal-practice, mis-feasance or simple disinterest on the part of corporate management; the religious presumption has always been that companies want to be saved, regenerated and given the ability to discharge their liabilities. Cultural, faith and arguably economic terms of corporate rescue through *non-riba* share exchange or through simple charitable acceptance of delay and trust in repayment are pursued as a logical way of achieving salvation than imposing punitive financial, monetary-based penalties. It certainly calls upon deep reserves of compassion and patience from investors, and *muflis* can only seek redemption through repayment of the debt or death. The latter appears a little uncharitable but is simply an extension of the Quranic Verse 5:1 demand to pay liabilities on time once they are able. The debt does not increase due to delay, for example, by the imposition of penalties; that would be tantamount to *riba* so the debtor would be committing a wrong against the investor which the latter was unable to counter.

Nevertheless, in times of financial impecuniosity and distress, a coherent framework of law for debtors facilitates time for restructure and planning through pre-emptive schemes, a return to

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<sup>185</sup> Areej Abdullah Aljumzi, 'The Impact of Islamic Culture on Business Ethics: Saudi Arabia and the Practice of Wasta' (PhD Thesis, Lancaster University 2017) 89.

<sup>186</sup> MH Yahya and others, 'Chinks in the Capitalism System – The Pertinence of Islamic Finance' (2013) 7 Journal of International Business and Cultural Studies 6.

solvency and compliance. However, it appears that the creditor may only rely on ethical, moral and religious obligations against debtors. Saudi companies facing financial distress may not receive the same consideration or compassion from, for example, secular western creditors, but it could further be argued that they should not have entered into haram agreements with them in the first place. However, the legislative framework will effect standards upon which the debtor, acting in good faith and in accordance with obligations, can rely.

Religious imperatives of compassion and charity differentiate the focus of bankruptcy law from the Western concepts and practices of: (i) entity-shielding, emphasising the protection of company interests from creditors,<sup>187</sup> a fundamental basis of the US Chapter 11; (ii) time value and risk value of money; and (iii) non-possessory and intangible rights and assets.<sup>188</sup> The concept of 'time value' essentially gives the debtor considerable control over money raised for survival from the financial turmoil the management failed to avoid,<sup>189</sup> albeit at an enhanced level of interest to compensate for the creditor risk. The risk value principle factors uncertainty of return into the lending through an interest premium or ownership transfer through bail out, and even exposure to potential debtor fraud or entity-shielding measures.<sup>190</sup>

Western bankruptcy practices take risks into consideration by creating mechanisms which permit the creditor to compel the debtor to meet obligations under penalty of punitive action and transactions. This is in stark contrast to the *Shari'a* principles predicated on a high level of trust in which the time value of money is the holding to account of the debtor for unforgiven debt until such time as the economic strain eases the burden to facilitate the opportunity to meet financial obligations.<sup>191</sup> 'Money', it has been noted, is not held in the same esteem in *Shari'a*, and therefore it is arguable that risk value practices have no role in the KSA law given

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<sup>187</sup> Henry Hansmann, Reinier Kraakman and Richard Squire, 'Law and the Rise of the Firm' (Harvard Discussion Paper 546 2006) 12 <[http://www.law.harvard.edu/programs/olin\\_center/papers/pdf/Kraakman\\_et%20al\\_546.pdf](http://www.law.harvard.edu/programs/olin_center/papers/pdf/Kraakman_et%20al_546.pdf)> accessed 20 September 2019.

<sup>188</sup> Awad and Michael (n 30) 980.

<sup>189</sup> Rafael I Pardo, 'Reconceptualizing Present-Value Analysis in Consumer Bankruptcy' (2011) 68 Washington and Lee Law Review 113, 120.

<sup>190</sup> Jean Helwege, 'Financial Firm Bankruptcy and Systemic Risk' (Penn State University April 2009) <<https://www.bankofcanada.ca/wp-content/uploads/2010/09/helwege.pdf>> accessed 20 September 2019.

<sup>191</sup> Awad and Michael (n 30) 980.

that it is essentially a concept imbued with potential punishment. It is considered a means to a better societal standard of living and not a method for simply generating more of itself, essentially *riba*.<sup>192</sup> As such, it has no exchange value and cannot, in accordance with *Shari'a*, be subject to market forces of supply, demand and variation in worth; it is endogenous, existing only because it is used.<sup>193</sup>

#### **4.5. Assessment and Comparison**

The *Shari'a* perspective of bankruptcy and debt restructuring associated with the *riba* prohibition and, albeit optional religious implorations of compassion and charity, have resulted in the development of a unique jurisprudence on bankruptcy law. Temporary respite during periods of economic hardship is provided for in the pre-emptive preventive settlement process moratorium which allows time for financial reorganisation. The Holy Quran, it has been noted, imposes a duty on the debtor to effectively stabilise his finances and meet financial obligations. It has been noted that, under the SABL 1996, failure to pay debts may result in the imprisonment of the responsible management. This is arguably unique, certainly in the jurisdictions studied in Chapter III, except where fraudulent activity is identified, whereupon the criminal law will sanction such behaviour. This has been retained in Articles 200 to 202 of the BL 2018, with corporate jurisdiction penalties carrying up to 5 years imprisonment and substantial fines for dishonesty or the mishandling of corporate assets.<sup>194</sup>

There is no time limit imposed on the demand that a company stabilise its finances and pay its debts under the court regulated restructure procedure. This is perhaps because time is not a justification for penalties or the *riba* increase of debt but rather an issue between the debtor and their faith. In terms of the performance of the debtor's obligation to rejuvenate his business, the creditor can expect to get back what he put in. This does not, however, prevent the creditor from renegotiating the nature of their interest in the company, and thereafter profiting from their effort and commercial risk undertaking, for example, as a share or stock

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<sup>192</sup> Hans Visser, *Islamic Finance: Principles and Practice* (Edward Elgar 2009) 25.

<sup>193</sup> Masudul A Choudhury, *Money in Islam: A Study in Islamic Political Economy* (Routledge 2005) 36.

<sup>194</sup> Najm (n 81).

holder, provided that the initial value is of the same monetary value. In so doing, the creditor becomes an effective partner, sharing risk and reward.

Whilst respite and reorganisation are inherent features of the UK scheme of arrangement, and indeed exchange of value in restructures, *Shari'a* places limitations on the type of rearrangement agreement or compromise that a financially distressed corporation can execute with its creditors. Under English law, the scheme of arrangement is a regulated process in a freely entered into agreement between the parties. The punitive imposition of interest on loans or penalties for delay is a common feature of conventional Western financing. It is considered just, in a secular context, because of the increased risk of working with a distressed entity.<sup>195</sup> Under *Shari'a*, it is permissible to exchange the value of debt for shares and stocks.

It is evident that the BL 2018 demonstrates that it has taken on board the global corporate law principle of rescue and rehabilitative alternatives to traditional bankruptcy by the financial reorganisation and preventive settlement programmes that it contains. As with all the jurisdictions reviewed, companies are afforded the opportunity to enter into binding agreements with creditors and propose a diversity of debt restructuring arrangements which permit the debtor to continue its operations as it services its debts. *Shari'a* principles and duties do not interfere with that process to any appreciable extent, except perhaps in financing.

Article 2 of the BL 2018 follows an international legislative precedent by refraining from defining limitations on types of arrangements that fall within the scope of the financial restructuring, thus preserving the context of need in the relationship between arrangement, agreement and compromise. The English High Court in *NFU Development Trust Ltd* stressed the need for arrangement and compromise in rejecting a plan as contrary to the meaning of the compromise envisaged by a scheme of arrangement because it offered no compensation for the expropriation of rights of the distressed corporation.<sup>196</sup> This taking advantage of a wounded

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<sup>195</sup> John C Murray, 'Case Law Summary - Default Interest and Late Charges' (American Bar Address 2012) <[https://www.americanbar.org/content/dam/aba/publishing/rpte\\_ereport/2012/5\\_october/rp\\_murray.authcheckdam.pdf](https://www.americanbar.org/content/dam/aba/publishing/rpte_ereport/2012/5_october/rp_murray.authcheckdam.pdf)> accessed 20 September 2019.

<sup>196</sup> *NFU Development Trust Ltd* [1973] 1 All ER 135.

entity would certainly not have been accepted by the KSA legal authorities because it is incompatible with *Shari'a* principles.

The international perspective on the fairness and reasonableness of schemes of arrangement as compromise are reflected in the BL 2018, at least insofar as the agreement principle is concerned if not the nature of the deal, which is a particular issue of faith. In *International Harvester Co of Australia Pty Ltd*, an Australian court noted that state law resisted the temptation to define the scope of schemes of arrangement provided that compromise and agreement were evident between the company and stakeholders and that it was not *ultra vires* the corporation's articles of association.<sup>197</sup> All forms of renegotiated proposals for the repayment of a particular creditor or class would constitute a scheme for the purposes of the flexible process of restructure provided it was one that a reasonable businessman would enter into in good faith in the ordinary course of business.<sup>198</sup> These matters are yet to be examined by the Saudi courts.

Historically, the English courts have arguably taken the concept and meaning of compromise somewhat beyond its literal meaning, viewing 'arrangement' as broader than 'compromise'.<sup>199</sup> It can include situations in which the primary beneficiary of the arrangement, normally the company, was not experiencing financial distress but wished or needed to restructure for other business reasons. Section 895(2) of the Companies Act 2006 makes a similar point when it states that the term 'arrangement' can include share capital reorganisation through consolidation or division into different classes.

In this context of the broader value to business of a scheme of arrangement, the BL 2018 is somewhat more restrictive in its reorganisational provision, largely to corporate financial distress. This requirement is not a feature of international jurisdictions. There may be, arguably, inherent scope, particularly under the Saudi pre-emptive, preventive settlement process and

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<sup>197</sup> *International Harvester Co of Australia Pty Ltd* (1995) 182 CLR 423.

<sup>198</sup> *ED White Ltd* (1929) 29 SR (NSW) 389.

<sup>199</sup> *Guardian Assurance Co* [1917] 1 Ch 431.

the lack of definition of 'arrangement' for interpreting in the law a broader financial restructuring procedure which in the UK is a product of the common law practice of precedent.

Procedural standards of compliance with the BL 2018 are set out in the 2018 Bankruptcy Law Regulations governing the implementation of the reorganisation processes enacted.<sup>200</sup> They reflect international expectations of transparency in terms of full disclosure of difficulties and scheme plans and agreements to facilitate understanding and a reasoned vote from stakeholders.<sup>201</sup> The beneficiary of the financial reorganisation scheme must deposit documents on the vote which led to its approval with the court for the purposes of ratification.<sup>202</sup> The Regulations are however silent on the factors the court will take into account before approving the arrangement.<sup>203</sup> Nevertheless, it is safe to assume they will include compliance with the principles of *Shari'a* and are not unreasonable, onerous and intended to defeat the ultimate objective of rescue and rehabilitation.

#### **4.6. Conclusion**

The Vision 2030 initiative aims to diversify the KSA economy, attract a vibrant private sector with greater support from a macroeconomic fiscal policy which would increase the entrepreneurship and employment prospects and opportunities for Saudi citizens.<sup>204</sup> The BL 2018 is identified as a key step in reducing obstacles in the plans of the Kingdom for a diversified post-oil economy.<sup>205</sup> In the development of a legislative programme for dealing with corporate financial distress, the government has evidently researched and assimilated the most effective and balanced processes for managing the range of interests and obligations which arise in the context of potential business failure.

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<sup>200</sup> Implementing Regulations of the Bankruptcy Law, No 4744, 1439 (2018), 4.

<sup>201</sup> *ibid* art 41.

<sup>202</sup> *ibid* art 46(3).

<sup>203</sup> *ibid* art 42.

<sup>204</sup> IMF, 'IMF Staff Completes 2017 Article IV Mission to Saudi Arabia' (Press Release 17/178 17 May 2017) <<https://www.imf.org/en/News/Articles/2017/05/17/pr17178-imf-staff-completes-2017-article-iv-mission-to-saudi-arabia>> accessed 20 September 2019.

<sup>205</sup> *ibid*.

The new legislation is attractive to domestic and international companies given the emphasis of the pre-emptive, preventive settlement and financial reorganisation on rescue and, arguably, recuperation from the trials of the market. Other jurisdictions, it has been noted, place the balance of control over company operations during the period of rehabilitation in the hands of creditors through the imposition of onerous terms for continuing support. The Saudi process, by contrast, places a level of trust in the corporate-debtor beneficiary of the preventive settlement scheme to rectify its faults during a period of grace in order to comply with legal obligations. Nevertheless, actions and decisions of the management of the debtor company are generally monitored by a licensed bankruptcy trustee, the final arbiter of contracts to be fulfilled and those which are to be cancelled, and control over asset management in the preservation of creditor interests to avoid prejudice and achieve balance.

The restructuring procedures are predicated on *Shari'a* principles which focus on societal value and life improvement, an expectation that those who potentially and unintentionally cause loss will recover and perform their legal and religious duties. The attractions of respite and fairness are unquestionable when a company seeks survival and assistance from those who will share in its suffering. The options available to the creditors to protect their stake are limited by prohibitions on speculation and charging interest, but the sharing of risk with the perspective of eventual recovery is an obvious alternative to experiencing substantial loss through corporate collapse.



## 5. Chapter V: Discussion and Conclusion

### 5.1. Introduction

This chapter will draw together the answers to the primary research question of this study: *With particular reference to the UK, the KSA and other selected jurisdictions, to what extent do schemes of arrangement provide an effective alternative to other restructuring tools available under corporate law?* In seeking an explanation, clarification has been achieved of a number of other issues:

- i. The nature of other restructuring tools in national company law, with an assessment of their effectiveness in providing solutions to reorganisation needs,
- ii. the meaning and constituents of ‘schemes of arrangement’ processes and how useful they are for restructuring organisations and resolving problems of potential or actual insolvency,
- iii. the ‘source’ of schemes of arrangement, discussions of the phenomenon and effect of ‘legal transplantation’ across diverse jurisdictions with particular market dynamics, trade practices, and politico-economic and socio-cultural environments, and
- iv. with specific reference to the KSA the extent to which *Shari’a* law stands in opposition to schemes of arrangement and other restructuring mechanisms.<sup>1</sup>

This enables reflection to be undertaken on whether it is feasible and desirable to establish a globally recognised scheme of arrangement regime, perhaps drafted by UNICITRAL to command at least grudging respect and the role, if any, the KSA might play as a major developing world power reflecting its regional influence making the Kingdom an integral part of the globalised market economy.<sup>2</sup>

The lessons of the global economic breakdown in 2008 have continuing relevance in the vibrant, competitive international market for goods, services and skills, which is awash with

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<sup>1</sup> See Chapter I, 1.10.

<sup>2</sup> See Chapter I, 1.2 and 1.4.

opportunities and risks and where only the most adaptable participants will survive and thrive. Adaptability requires change, and in a fickle, capricious market environment in which a diverse range of interests must be accommodated and protected, effective models of corporate restructure must be facilitated by the law. This study has examined how UK law aids corporate structural evolution in times of financial distress and growth, and the rejuvenation of the company's operation to take advantage of change. It facilitates streamlining and reorganisation in an effort to deal with market change and corporate diversification.<sup>3</sup> The failure to use, or inadequacy of, a restructure strategy is exemplified by the UK-based Carillion conglomerate when in 2018 there was a lack of management foresight and competence which resulted in its collapse.<sup>4</sup> It appears that the management of Thomas Cook Travel had attempted scheme reorganisation of structure and debt when the decay had set in and the foundations of the company were weakened by market changes and political turmoil.<sup>5</sup> Merger and expansion can only lead to productive growth and success where the joint entities change the way they all operate, as evidenced by the Flybe-Connect arrangement.

The British Steel experience of demise is a salutary lesson that even where rescue options are examined, new owners sought or takeovers invited, and initial commercial assessment indicated the business itself may not be attractive enough to survive international competition.<sup>6</sup> The simple injection of finance is insufficient of itself to rescue even the most fundamental manufacturing.<sup>7</sup> Government intervention too is discouraged as it is contrary to free competition principles in the international market, but in any case, the experience of such

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<sup>3</sup> Neil M Kay, *Pattern in Corporate Evolution* (Oxford University Press 2000) 146.

<sup>4</sup> Business, Energy and Industrial Strategy and Work and Pensions Committees, *Carillion (Second Joint Report)* (2017–19, HC 769).

<sup>5</sup> Patrick Collinson, 'Why did Thomas Cook collapse after 178 years in business?' (The Guardian 23 September 2019) <<https://www.theguardian.com/business/2019/sep/23/thomas-cook-as-the-world-turned-the-sun-ceased-to-shine-on-venerable-tour-operator>> accessed 20 September 2019.

<sup>6</sup> Jasper Jolly, Rob Davies and Jessica Murray, 'British Steel Enters Insolvency after Rescue Talks with Government Fail' (The Guardian 22 May 2019) <<https://www.theguardian.com/business/2019/may/22/british-steel-to-enter-insolvency-after-rescue-talks-with-government-fail>> accessed 20 September 2019.

<sup>7</sup> Rob Davies, 'Oyak: Turkish buyer of British Steel with direct ties to the military' (The Guardian 16 August 2019) <<https://www.theguardian.com/business/2019/aug/16/british-steels-turkish-buyer-owned-by-oyak-military-pension-fund>> accessed 20 September 2019.

action in relation to failing banks in 2008-2009 gives rise to significant political contention even when reconstruction of the regulatory frameworks and institutional structure is effected.

Reorganisation of the company may also be in preparation for, and as a reaction to, extrinsic legal compliance, political developments and volatile market demand. The corporate management and organisational framework cannot remain in a condition of stasis whilst those all around it reverse, revive and advance. Support and protection must be provided by the legal framework. The KSA experience shows that the SABL 1996 practices of ad hoc private arrangements to temporarily solve crises exclude the legal interests of the whole body of members and creditors, and lack judicial oversight of fairness and transparency.

The turbulent political, economic and social pace of business in a domestic and global market requires effective national laws which reflect the protection of the diverse interests of the corporate body. It is evident from the politico-legal philosophy of the UK and other countries examined that the law provides considerable opportunities to companies to develop, evolve and be rescued from demise even through insolvency by the scheme of arrangement process. This has guided the development of a research title to meet the aim of examining how the flexibility of the multi-purpose scheme of arrangement procedure is more effective in satisfying the diverse needs of corporate restructure in the international market.

The research has examined the law on insolvency, mergers, takeovers and other reorganisational demands of companies and considered the extent of the improvement made by schemes of arrangement compared to the other methods of restructure. This has assisted in the evaluation of the benefits of the flexible scheme process in corporate law. This simpler framework of effecting corporate adaptation has to a significant extent superseded the value of the formality inherent in the 'old' laws of the nations examined. This has proved particularly valuable in rationalising the law in the KSA. It is argued that this study therefore supports the hypothesis inherent in the research title that schemes of arrangement are a relatively effective and efficient means of restructuring companies. It ensures, insofar as is practicable, a balance of fairness and reasonableness in the accommodation of the rights and interests of members

and creditors with the primary focus on corporate rescue and rehabilitation, and on meeting the standards for recognition of international jurisdictional recognition.

In the Saudi context, ambitious plans are in place in the Vision 2030 and the NTP 2020, and the law must support the fundamental changes to corporate and economic practices. Reform has to balance the diverse, often-conflicting interests of the company, its members and creditors across the world and be culturally appropriate to the traditions of the nation in which they are effected. The former laws of insolvency, restructure of debt and corporate reorganisation have proved inefficient in terms of time, cost and administration, as well as profoundly restrictive and generally unsuccessful. The corporate culture indeed enabled opaqueness in operation and considerable damage to the interests of those creditors and non-family members who lacked practical, if not formal, protection. It further encouraged a self-aggrandising attitude and subterfuge in dealings and dishonesty which are so fundamentally condemned by *Shari'a*. The BL 2018 has benefited from the frameworks of other, secular nations which it is anticipated will vastly improve the operation of its own laws, encouraging employment creation, entrepreneurship and foreign investment in a new economy.

The effectiveness of the scheme of arrangement also depends on the experience of the judiciary, fairly balancing conflicting interests, and reasonably meeting corporate needs for better control over their own fates. These issues have been examined in the context of tradition and corporate culture, the effect of influence from the historically mature legal structure of the UK, and the economic, social and political challenges faced by a nation.

#### *5.1.1. Purpose of Study and Contribution to Knowledge*

The KSA's long-term economic goal is diversity of business and corporate opportunity with wealth generation from a broad, private, globally competitive commercial and legal environment providing employment and the advancement of the nation, based on institutional reform reflected in its Vision 2030 initiative. The BL 2018 has been examined in the context of this economic requirement. Indeed, the adoption of the processes common to international

jurisdictional restructure practices are attractive to foreign commercial enterprises and domestic entrepreneurs.

Given the recent introduction of the BL 2018, there has been no other academic analysis undertaken in the context carried out in this research. Much of the value of the legislation depends on its jurisprudential use but it has been appraised both in the international context and domestic compatibility and found to be invaluable to the Vision 2030 initiative developments, and its Progress Review in 2020. The research began with a set of objectives and questions aimed at examining specific fundamental issues, both international and domestic, which have been met in a manner that provides concise guidance to the Saudi government and academics on the operation of the law.

### *5.1.2. Development of the Research*

The structure of the study has been designed to examine the legislation of diverse jurisdictions and how the law seeks to serve the fostering of commercial organisations in the growth of national and global economies in a competitive world market. Companies must evolve to survive and thrive in times of commercial success and decline, accommodate both rationalisation of operation and growth, and overcome what Sull describes as ‘active inertia’.<sup>8</sup> The UN Model Law is limited to recognition of the orders of foreign jurisdictions but is voluntary and subject to sovereign and national cultural standards and expectations, and is therefore of limited value. In the EU, the Harmonisation Directives, particularly 2017/1132, aim to ensure a smooth transition in the single market for a newly structured entity.

The modern global market battle for commercial competitive advantage means that companies cannot afford to become “stuck in the modes of thinking and working that brought them their initial success. When business conditions change, their once-winning formulas instead bring failure”.<sup>9</sup> In the context of the need for restructure, reorganisation and adaptation, this

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<sup>8</sup> Donald Sull, ‘Why Good Companies Go Bad’ (July-August 1999) Harvard Business Review <<https://hbr.org/1999/07/why-good-companies-go-bad>> accessed 20 September 2019.

<sup>9</sup> *ibid.*

examination has evaluated the theoretical and practical processes of the corporate restructuring mechanisms and how their weaknesses have been addressed by national governments with schemes of arrangement. As such, it has addressed the first objective of the research of establishing the broad benefit of the scheme in its framework as a more flexible and adaptable, judicially-overseen legislative process, whose resultant changed corporate entities are recognised across international jurisdictions.<sup>10</sup>

The law must keep up with international market and legal changes, as outlined in Chapter I on the issue of globalisation of commerce and through a review of the domestic market aims in subsequent chapters. This has led to a search by each of the jurisdictions examined for a flexible mechanism for adapting commercial principles and practice to economic needs. The KSA has over recent decades recognised the need for swifter development of a diverse, non-oil and state-dependent economy. Its Vision 2030 initiative is indicative of the acknowledged urgent need for an overhaul of business practice and entrepreneurship encouragement to cope with global change and a fast-accelerating birth rate, with regional, corporate, agricultural and business reform vital to ensure independence.<sup>11</sup>

In the particular focus on the legislation, both past and present, the adoption of schemes of arrangements by advanced industrialised and manufacturing nations is *per se* indicative of their perceived value to a vibrant economy. They are seen as a flexible and efficient means of rearranging corporate affairs which address the weaknesses of the single-purpose and administratively burdensome restructuring mechanisms used in their corporate law. Indeed, most jurisdictions have retained the law and regulations of such actions as insolvency management, merger, takeover and debt restructure, as well as introducing a more adaptable and flexible procedure of the judicially-monitored scheme. Different corporate structures have diverse needs and there is no single method, one-size-fits-all way of ensuring survival, growth,

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<sup>10</sup> See Chapter I, 1.7. and Chapter II, 2.2.2. & 2.2.3.

<sup>11</sup> Nkem O Obaji and Mercy U Olugu, 'The Role of Government Policy in Entrepreneurship Development' (2014)

2(4) Science Journal of Business and Management 110-111.

<<https://pdfs.semanticscholar.org/708c/a90050c3c57373cca5bdc2890203916846e8.pdf>> accessed 20 September 2019.

increased competitiveness and strength. The scheme of arrangement is but one flexible and adaptable way of meeting company goals. It does not preclude the use or undermine the value of the other statutory mechanisms discussed in this thesis.

The introductory chapter provided a broad description of the changing and volatile free trade market within which corporations must strive to survive and thrive in a world of fluid borders and rapidly evolving communications technology. The capacity to conduct multinational trade from an armchair now requires suppliers of goods and services to make them available in the manner demanded by their worldwide customer base.<sup>12</sup> Business is now conducted in an environment of political and economic instability outside of the control of the corporate entity. Risks abound and “restructuring represents an essential reconstruction of an enterprise strategy, structures and processes and their tuning with the new reality”.<sup>13</sup> This can only be achieved where there is a national legal framework, regularly reviewed and updated, which facilitates change and diversification.

The question posed in the Introduction, and answered in the jurisdictions examined, was what constituted a ‘scheme of arrangement’ in national law and how it served as a valuable legal mechanism for restructuring organisations and resolving problems of potential or actual insolvency.<sup>14</sup> A detailed description of the UK concept of the scheme was provided in Chapter II as a basis for investigating the procedure as it was applied in the jurisdictions examined in Chapters III and IV. There is a considerable degree of uniformity in the framework of how the schemes are effected in the diverse historical contexts, cultures and politico-economic priorities of the states examined. Chapter I made reference to related issues which affect the imperatives for change in national law to accommodate international needs. These are particularly identified as: (i) sovereignty and resistance to perceived political and cultural intervention,<sup>15</sup> (ii) accessibility of domestic and international companies to the legislative programmes of the

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<sup>12</sup> See Chapter I, 1.1. et seq.

<sup>13</sup> Libena Tetreva, ‘Concept of Corporate Restructuring and Re-engineering’ (University of Pardubice 2007) <<https://pdfs.semanticscholar.org/e34e/143c1a361e1707dc50e8db255dee92636255.pdf>> accessed 20 September 2019.

<sup>14</sup> See Chapter I, 1.7. et seq.

<sup>15</sup> See Chapter I, 1.8. et seq.

states,<sup>16</sup> (iii) recognition by the market and foreign jurisdictions of the emerging restructure entity<sup>17</sup>, and (vi) accommodation of international claims and interests.<sup>18</sup>

The jurisdictions differ not only in their history, culture, politics and the independent sovereign imperatives of government but also in the foundation of the legal system. The UK, for example, being a common law jurisdiction and the KSA being governed under a civil code.<sup>19</sup> This has had an effect on the flexibility of the scheme, with precedent in the UK guiding a more generic development of adaptation to corporate needs.

The KSA only introduced a coherent operative scheme of arrangement into its Bankruptcy Law in 2018. It was noted in Chapter IV that the judiciary has shown, in its first major challenges in the form of the Saad Group and Ahmad Hamad Algozaibi and Brothers (AHAB) conglomerate collapses, strict adherence to the civil code of the Decree stipulations.<sup>20</sup> It was further asserted in Chapter II that the Companies Act 2006 (CA 2006) is more descriptive of the legislative restructure process rather than prescriptive, allowing greater flexibility for corporations to regulate their own operational restructuring subject to governance principles of openness, integrity and accountability.<sup>21</sup>

A particular emphasis in this study is on UK and KSA laws and reference is made in Chapter I to 'legal transplantation'.<sup>22</sup> Whilst this may be a remnant of a past relationship with the British Empire, it is arguable that the UK's long history of company law simply provides a sound base example of adopting laws which have been tested and work for ubiquitous corporate needs. The Saudi Law has not been transplanted, although there has been a close political and economic relationship between the countries throughout the 20<sup>th</sup> Century, simply an

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<sup>16</sup> See Chapter I, 1.5.6.

<sup>17</sup> See Chapter I, 1.2.

<sup>18</sup> For example, see Chapter I, 1.5.6.

<sup>19</sup> See Chapter I, 1.8.2.

<sup>20</sup> See Chapter I, 4.3.1. Also, see Gulf Business, 'Saudi Court Rejects Conglomerate AHAB's Filing under Bankruptcy Law' (*Gulf Business*, 16 February 2019) <<https://gulfbusiness.com/saudi-court-rejects-conglomerate-ahabs-filing-bankruptcy-law/>> accessed 20 September 2019.

<sup>21</sup> See Chapter I, 2.2.2.

<sup>22</sup> See Chapter I, 1.8.



adaptation of best practice to a cultural context.<sup>23</sup> Further, an authoritative scheme of arrangement process, monitored by an experienced, non-interventionist judiciary, will stimulate the economy and preserve a dynamic corporate environment. The BL 2018 is indicative of a profound change of corporate practice in the Kingdom.<sup>24</sup>

## **5.2. Schemes of Arrangement: the UK Experience**

The UK is used herein as an exemplar of how to achieve modernisation of a corporate law regime that is most suited to the international markets of the 21<sup>st</sup> century simply because of the longevity of its specialist legal framework which has undergone regular adaptation and change. Chapter II concentrates on the history of UK corporate law insofar as it relates to insolvency, rescue and reconstruction, and acts as a comparator to the nations examined in the thesis in terms of the global adoption of schemes of arrangement legislation and procedure.

The UK has a global reputation for being creditor-friendly and essentially a pioneer of corporate governance principles.<sup>25</sup> It is, however, somewhat of a late-comer to the imperative of corporate rescue as the first port of call for financial distress and risks of company demise. Its evolution toward the doctrine of rescue and rehabilitation began with dissatisfaction with insolvency law which was voiced by the Cork Report in 1982.<sup>26</sup> Although the Insolvency Acts of 1986, 1994 and 2000 coupled with the Enterprise Act 2002 (EA 2002) dealt primarily with the process of demise, avoidance of liquidation via an administration procedure provided an alternative which had the potential to guide a company away from the precipice.<sup>27</sup> The rescue principle was further embedded in the EA 2002<sup>28</sup> and eventually, insofar as the schemes of

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<sup>23</sup> See Chapter I, 1.8.2.

<sup>24</sup> See Chapter I, 4.2.3.

<sup>25</sup> John Michael Wood, 'Corporate Rescue: A Critical Analysis of its Fundamentals and Existence' (PhD thesis, University of Leeds May 2013) 7 <[http://etheses.whiterose.ac.uk/4963/1/Wood\\_JM\\_Law\\_PhD\\_2013.PDF.pdf](http://etheses.whiterose.ac.uk/4963/1/Wood_JM_Law_PhD_2013.PDF.pdf)> accessed 20 September 2019.

<sup>26</sup> Review Committee on Insolvency Law and Practice, *Report* (Cmnd 8558, 1982).

<sup>27</sup> The Insolvency Service, 'Enterprise Act 2002 - Corporate Insolvency Provisions: Evaluation Report January 2008' (January 2008) 10

<<https://webarchive.nationalarchives.gov.uk/20080610162953/http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/EA02CorporateInsolvencyReport.pdf>> accessed 20 September 2019.

<sup>28</sup> *ibid* 24.

arrangement procedure is concerned, Part 26 of the CA 2006. Little has been undertaken by Parliament in the further reform in this area of corporate law in times of distress and threat, although a moratorium remains a provision subject to evaluation.<sup>29</sup> It is evident, however, that the courts have been busy in the realm of company restructure. The scheme may not be a one size fits all method of corporate restructure but its cloth is cut as necessary by unrivalled judicial experience and discretion to suit a wide range of needs. It is suggested that such frenetic legislative activity reflects some confusion on the part of Parliament regarding how to effectively deal with corporate problems within the relatively *laissez-faire* capitalist market philosophy.

The Australian Corporations Act 2001 (Section 411) and the earlier Canadian Business Corporations Act 1985 (Section 192) made specific reference to the scheme of arrangement procedure. These former British colonies have a common law foundation and it is noted that the restructure process is based in the company law framework. This contrasts with Germany which has a civil code, and its Insolvency Act 2004 (section 27) sees reorganisation as an insolvency avoidance process. Germany lacks a unified central court administration which causes uncertainty and, pending operation of the 2019 Directive of harmonisation between the EU member states, there is an inherent degree of friction that exists between company and insolvency law and the operation of the Single Market.<sup>30</sup>

### 5.2.1. Essential Features

The features of the UK legislative scheme have been adopted by all the jurisdictions examined, some of which are former colonies where UK common law traditions remain, for example, Australia, Canada, Hong Kong, New Zealand and Singapore. The KSA has never been subject to UK control, nor indeed does it have a comparable system of national government. Its cultural framework is fundamentally different from all states considered yet the BL 2018 has adopted

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<sup>29</sup> Select Committee on Trade and Industry, 'Second Report: The Trade and Industry Committee on Draft Insolvency Act' <<https://publications.parliament.uk/pa/cm199900/cmselect/cmtrdind/112/11206.htm>> accessed 20 September 2019.

<sup>30</sup> Carsten Gerner-Beuerle and Edmund Schuster, 'The Costs of Separation: Friction Between Company and Insolvency Law in the Single Market' (2014) 14(2) Journal of Corporate Law Studies 287, 289.

the practices of judicial monitoring and approval of corporate reorganisation. Germany has no such historical link of control by Britain and is instead integrally linked to the 26 other EU members in a quest for harmonisation of domestic law. The Treaty on the Functioning of the European Union envisages harmonisation of the laws of Member States to ensure comity between nations. The Preventive Restructuring Directive 2019/1023 was adopted by the members to facilitate the capital free movements and freedom of establishment.<sup>31</sup> In consultation for some seven years, many of the states, including the UK, had already effected procedures for recognition of member orders.

The Directive does not require parity in the terms of restructure and refinancing practices, rather the aim being the removal of territorial barriers to restructure regimes and recognition and respect for the national legal systems of members.<sup>32</sup> Article 4 simply requires that national law accommodates a restructure process in accordance with the principles espoused in some considerable detail in the preamble to the Directive. Both Germany and the UK are bound to the Directive requirements by Treaty, at least, in the case of the UK, until a decision is made on EU membership. No moratorium protection from legal proceedings has yet been incorporated in UK law, unlike several of the jurisdictions examined in Chapter III, which is, in fact, a feature of the KSA law.

The specifics of scheme operation across the jurisdictions may differ in emphasis but, as explained in Chapter II, the fundamental features in Part 26 of the CA 2006 may nevertheless be divided into broad, and evidently common, attributes, particularly where the focus is on reconstruction of the company:

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<sup>31</sup> Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 [2019] OJ L172/18.

<sup>32</sup> *ibid* para 16.

- i. The scheme is primarily a voluntary plan for change, developed and introduced to the court by the directors to effect reorganisation of structure or liabilities, a reflection of their governance duties to promote the best interests of the company;<sup>33</sup>
- ii. Section 896 of the CA 2006 then regulates the approval of the scheme in practice to ensure fairness and minimisation of prejudice, particularly to minority shareholders;
- iii. The authority of the court is sought to arrange meetings of interested parties, classes of creditors and members to be affected by the restructure, essentially commencing judicial oversight of legislative compliance;
- iv. The disclosure, meetings and approval process is implemented, requiring 75% support for the scheme from affected members and creditors;<sup>34</sup>
- v. The court will then be asked to approve the changes, affecting worldwide member and creditor rights, a sanctioning process binding on all parties that depends on proof only of legislative compliance, not judicial wisdom;<sup>35</sup>

It may be argued that the framework has been lifted from the UK and simply inserted into the corporate or insolvency law of the host state, with perhaps some adjustment to account for tradition and culture. This has to be considered in the context of similarity, but it does not reflect the interpretation of the findings of this research. Corporate needs in the global market are ubiquitous in terms of flexibility and adaptation to change.

It is argued that the other methods of reorganising business frameworks, liabilities, assets and operations, potentially effective separately and for their specific stated purpose, are increasingly unsuited to the diversity of corporate needs and circumstances, given the size and complexity of today's enterprises. It was noted in Chapters II and III that the nations examined maintain disparate laws and procedures enacted for different corporate actions, for insolvency, debt reconstruction, takeovers and internal operational needs. This study has addressed how diverse corporate needs may be satisfied by the adaptability of the scheme of arrangement

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<sup>33</sup> Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge University Press 2014) 18-19.

<sup>34</sup> Christian Pilkington, *Schemes of Arrangement in Corporate Restructuring* (Sweet and Maxwell 2013) 15-19.

<sup>35</sup> Geoff O'Dea, Julian Long and Alexandra Smyth, *Schemes of Arrangement: Law and Practice* (Oxford University Press 2012) 1.11-1.12.

procedure, thus meeting the aim of evidencing the efficiency of the court monitored process which facilitates the balance of fairness between diverse interests and reasonableness.

### *5.2.2. Creditor and Member-Shareholder Protection*

Corporate restructuring, whether intended to deal with issues of financial distress or to accommodate internal organisational change, expansion of the business by takeover or merger, or indeed contraction, will involve a renegotiation of liabilities in terms of timing, amount and satisfaction. UK legislation and enforcement, it has been noted in Chapter II, has a historical reputation for emphasis on creditor protection. The emphasis on corporate rescue in the EA 2002 has arguably adjusted the balance, the priority being company survival. Indeed, the scheme of arrangement procedure places considerable power in the hands of directors, with a primary duty to the company. Arguably, the priority of corporate rescue and business operational enhancement means the balance needs to be tilted from creditor protection toward the company, given that a healthy business organisation serves national economic imperatives more effectively through employment, societal contribution and revenue production.

Judicial monitoring of schemes aids transparency, fairness and equity to all interests so far as the practicalities of the process will allow. Chapter III indeed shows that such principles apply across the jurisdictions, and no doubt this contributes to international acceptance and enforcement of change arrangements.

In the UK and, subject to some adjustment, in the schemes of the other jurisdictions, all classes of creditors and members affected by the scheme must approve its provisions and plans. Integral to the approval process is informed consent which can only be gained through detailed disclosure of the financial position of the company, market conditions, reasons for the scheme and avoidance of service to special financial interests. This is a common demand of all the jurisdictions examined in Chapter III and indeed has been a power exercised by the KSA judiciary in refusing the plans under the BL 2018 in the matter of AHAB as detailed in Chapter

IV.<sup>36</sup> It is to be expected that the spirit of transparency, reasonableness and fairness shown by the Saudi courts will continue to be reflected in corporate law, heralding an era of clarity and trust for international investors.

The majorities required for scheme approval are twofold, namely 75% by value of creditors and more than half the number of the creditors present and voting at the scheme meeting (in person or by proxy) voting in favour of it, the ‘headcount’.<sup>37</sup> The special majority requirement is the primary method of creditor protection across all jurisdictions. The headcount demand is, however, contentious in all due to the logistical difficulties experienced by interested creditors and members in attending the class meetings. There are declared intentions to examine removal of that requirement from the different laws. The special majority seeks to avoid a potential disregard by the procedure of minority dissenters, and indeed it is arguably sufficient that their needs, so far as they are capable of accommodation in the primary focus of the legislation, are sufficiently protected by the courts in ensuring fairness and reasonableness. The headcount rule does, however, give added protection against a cram-down of minority interests.

The statutory dual voting demands nevertheless prevail, and this broadly explains the perception of UK law and the jurisdictions where the scheme is applied as being creditor-friendly, arguably to the detriment of company needs. The requirement of the second limb of voting requirements, the headcount, is burdensome and unnecessary, given the enhanced majority required of creditors as a whole. It is arguably anachronistic and certainly an inconvenient barrier to ease of use of the scheme procedure. As such, it is undergoing review, for example, in Hong Kong. There is little justification for its continued application in the light of the 75% by value approval voting requirement which can be undertaken electronically.

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<sup>36</sup> See Davide Barbuscia, ‘Saudi Court Rejects AHAB Bankruptcy Filings after Decade-long Dispute’ (Reuters 16 April 2019) <<https://www.reuters.com/article/saudi-debt-ahab/saudi-court-rejects-ahab-bankruptcy-filings-after-decade-long-dispute-idUSL5N21Y44O>> accessed 20 September 2019.

<sup>37</sup> Weil LLP, ‘Schemes of Arrangement as Restructuring Tools’ (Weil 2015) 4

<[https://eurorestructuring.weil.com/wp-content/uploads/2015/01/140553\\_LO\\_BFR\\_Schemes\\_Arrangement\\_Brochure\\_v12.pdf](https://eurorestructuring.weil.com/wp-content/uploads/2015/01/140553_LO_BFR_Schemes_Arrangement_Brochure_v12.pdf)> accessed 20 September 2019.

Member-shareholders arguably have a lesser part to play in the scheme process, although in any restructure they are likely to have their interests and rights changed or compromised. Much will depend on the purpose of the scheme plan, the avoidance of debilitating financial distress, facilitation of merger or takeover, or change of method of business operation. These issues are dealt with fully in Chapter II insofar as the UK is concerned, but it is worth noting that where their interests are compromised the voting requirements are similar to those of the creditors. This may simply be a change of area of registered base of operations, such as was the case with Barclays Bank's investment arm, Euroclear and Steris, discussed below in respect of Brexit reorganisation, or a takeover by major shareholders as in Flybe. In the latter case, all appears lost in the cancellation of shares, but the business is gained through issue of the new.

### 5.2.3. *New Corporate Accommodation*

Given that the focus of the study is the operation of the scheme of arrangement procedure and its role in corporate rescue, there has been little need, or indeed impetus, to comment in detail on outdated law which lacks the same broad application to diverse company affairs and needs. Indeed, it is the encompassing flexibility of the scheme which is attractive as an alternative to the former KSA legislation, the SABL 1996, and has proved so in considering the UK context. Voluntary arrangements, administration and liquidation, which are to some extent single purpose processes or essentially ones that deprive the company of control over its own affairs, do not therefore feature prominently in this research.

The scheme of arrangement in the UK was introduced essentially as a direct alternative to insolvency. Paterson calls it a "reliable friend to distressed companies and their majority finance creditors in the crisis".<sup>38</sup> It has proven to be in the aftermath of the 2008 global crash an effective solution to a variety of reorganisation needs in a single, judicially-monitored procedure. This is the value sought in the BL 2018, albeit that the legislative Decree is a

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<sup>38</sup> Sarah Paterson, 'Reflections on Schemes of Arrangement and the Insolvency Service Consultation on the Corporate Rescue Framework' (Oxford Faculty of Law 2017) 1. <[https://www.law.ox.ac.uk/sites/files/oxlaw/paterson\\_schemes\\_of\\_arrangement.pdf](https://www.law.ox.ac.uk/sites/files/oxlaw/paterson_schemes_of_arrangement.pdf)> accessed 20 September 2019.

declared feature of the insolvency framework rather than considered a separate company procedure, as in the UK, which carries less of a market stigma.

A particular example in the context of its otherwise impending demise is the Flybe Airlines takeover in 2019.<sup>39</sup> The company faced collapse due to increased competition and costs of operation, yet its business remained attractive and valued by Virgin and Stobart airlines as an integral link to their services. With a carefully executed scheme of arrangement, existing shareholders lost their stake in the original company, but the desired outcome of saving the service was achieved. This secured jobs, maintained relationships with other suppliers and external stakeholders and generated revenue for the community and economy, which was the priority of the responsible, logical and effective planned restructure process.

It is difficult to conceive how pre-existing legislative models would have enabled the maintenance of control by corporate management, broadly accepted compromise of associated member and creditor interests and a successful outcome, overseen by a judiciary focused on ensuring competing interests were fairly balanced. It is this form of outcome provision, predicated on the common good rather than vested interests, which provides examples for new adoptive states such as the KSA on how to achieve the best outcome from an unpromising situation. Herein lies support for the research aim and indicates UK case law's potential influence and effectiveness.

#### *5.2.4. Flexibility of an Adaptable, Multi-Purpose Procedure*

In meeting the primary aim of the study, the chapters have reviewed the history of legislation on merger and acquisition, insolvency, debt restructure, corporate rescue and structural reorganisation in diverse national legal frameworks. The scheme has proved more adaptable to the needs of business in a manner which commands international jurisdictional respect, particularly, as far as the focus of this research is concerned, where UK courts are utilised. It is a

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<sup>39</sup> Flybe, 'Recommended Cash Offer for Flybe Group Plc by Connect Airways Limited' (Announcement, 11 January 2019) <[https://www.flybe.com/application/files/6415/4719/1435/Joint\\_Offer\\_-\\_Rule\\_2.7\\_Announcement.pdf](https://www.flybe.com/application/files/6415/4719/1435/Joint_Offer_-_Rule_2.7_Announcement.pdf)> accessed 20 September 2019.



break with the past liabilities, members, creditors and revenue relationships which must be conducted with reasonableness, balance, fairness and transparency. The flexibility of purpose, a key factor in the aim of this research, is proven by its use in the UK insofar as acceptance of domestic authority is concerned. It is a relatively simple set of rules and procedures to follow, although no doubt complicated by the nature of the corporate entity.

#### 5.2.5. National Jurisdiction for Restructure

The starting point for restructure lies with the domestic law of the jurisdiction in which it is sought. In the case of the UK, the common law nature of interpretation and precedent has broadened the control of the local courts over corporations from around the world. Legislation for acceptance of jurisdiction over corporate change is simple yet remarkably opaque in its rules, applying to “any company liable to be wound up under the Insolvency Act 1986”.<sup>40</sup> It has been noted that the scheme is not considered an insolvency process in the UK as it is in the legislation of other nations, but nevertheless this contains stipulations of registration and business premises. The interpretive, common law discretion afforded to its courts has considerably expanded the rules in their arguably deliberate opacity.

In Chapter II it was noted that the High Court in *Rodenstock GmbH*<sup>41</sup> concluded that the phrase “any company” in section 895 of the CA 2006 enabled jurisdiction over foreign companies not registered in the UK effecting restructure plans.<sup>42</sup> The applicant company in *Vietnam, Primacom Holding GmbH vs Credit Agricole* expressed a simple desire to trade in the UK and in subsequent years it built commercial relationships in the jurisdiction and moved its centre of operations to the country.<sup>43</sup> This final step, it is suggested, was one that enabled the company to avail itself of the restructure provisions smoothly.<sup>44</sup> *Far East Capital Ltd SA*<sup>45</sup> involved a Luxembourg-

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<sup>40</sup> Companies Act 2006, Section 895(2)(b) [author’s emphasis].

<sup>41</sup> [2011] EWHC 1104 (Ch)

<sup>42</sup> See Chapter II, 2.2.5.

<sup>43</sup> [2011] EWHC 3746 (Ch).

<sup>44</sup> Kristen Gudewicz, ‘English Schemes of Arrangement of Non-UK Companies: Jurisdictional Issues’ (ACIC 7 January 2016) <<https://www.aciclaw.org/news/2016/english-schemes-arrangement-non-uk-companies-jurisdictional-issues>> accessed 20 September 2019.

incorporated group seeking sanction for debt restructure of its subsidiary in the Russian market. The fact that its shares were traded on the Irish stock market meant the EU rules on harmonisation of member jurisdictions under EU Directive 2004/39/EC, Article 4, applied.<sup>46</sup> The authority of the UK courts thus applied.

On jurisdictional matters, the goalposts have moved and access to the UK jurisdiction developed through the interpretive discretion of the High Courts and a judiciary of unrivalled level of experience. Connections with the country, creditors or member-shareholders resident therein and likely to be affected by scheme plans and simply doing business in the jurisdiction have been used by companies to seek the authoritative restructure procedure of the UK. The commercial benefits to the economy should not be underestimated, and indeed this is a significant factor in all of the jurisdictions examined. Corporate resettlement in the company-friendly law of the UK is attractive, and this is a particular focus of the KSA reforms. Legal fees revenue cannot be ignored.

#### *5.2.6. Chapter III Nations and the Exercise of Jurisdictional Control Chapter III: The International Development of Schemes of Arrangement: An Overview of Selected Jurisdictions*

The courts in the jurisdictions examined in Chapter III have shown considerable imagination in interpreting and adapting legislative limitations on jurisdiction to the acceptance of schemes from ostensibly foreign companies. Problems are particularly apparent in the German civil law jurisdiction in accepting authority from foreign companies to effect schemes and recognition of those carried out by other courts. Much needs to be done to effect greater unity between its own framework of composite state jurisdictions. This is a matter for resolution within the EU and is not part of the focus of this thesis.

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<sup>45</sup> *Far East Capital Ltd SA* [2017] EWHC 2878 (Ch) and see *Far Eastern Shipping Company*, 'Claim No. CR-2017-007385' (Scheme of Arrangement Documents) 22 <<https://www.fesco.ru/upload/iblock/380/explanatory-statement.pdf>> accessed 20 September 2019.

<sup>46</sup> *Far East Capital Limited SA*, 'Notification to Irish Stock Market' (27 October 2017) <[https://www.rns-pdf.londonstockexchange.com/rns/8773U\\_-2017-10-27.pdf](https://www.rns-pdf.londonstockexchange.com/rns/8773U_-2017-10-27.pdf)> accessed 20 September 2019. See also EU Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments [2004] OJ L145/1, art 4.

The common law jurisdictions of Canada, Australia and indeed all those examined which have a historical link with the UK purport to limit judicial authority to monitor and approve restructure schemes to those companies which are registered in their territory. They must do business there. This has been interpreted by the domestic courts to include domicile of creditors, members, or the ownership of property and incurring of debt in the jurisdiction. This is the benefit not simply of the scheme flexibility but also the adaptability of the common law, interpreted by the judiciary, to expand the reach of the nations. Their orders too are broadly accepted by the interested parties in other nations affected as a result of principles of comity but also due to the judicial monitoring of the fairness of the schemes of restructure.

This is a principle for freedom of establishment and movement of capital, facilitated by the obligations in the EU Preventive Restructuring Directive 2019/1023/EU.<sup>47</sup> Compliance and recognition of orders for restructure and bankruptcy in a common market eases commercial interactions and corporate support and survival, enhancing the international attractiveness of the otherwise diverse economies of members. The provisions of the law need not be the same, but simply sufficiently compatible with the cultural and national principles of international treaty relationships. It is not known how the absence of an agreement with the EU in the UK Brexit plans will affect such principles.

It is noted in Chapter III that Singapore and Hong Kong specifically market their legal services as a way of attracting business in a burgeoning legal and commercial market. This is also a foundation of the KSA procedure under the Vision 2030 initiative of economic diversification. This research provides a clear assessment of what needs to be done by the legislature and courts to develop the attractiveness of the KSA legal and commercial markets. This is preceded by the need for the development of a new SME market economy and the creation of relationships which regulate the methods by which investment is encouraged through corporate legal and international accommodation.

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<sup>47</sup> Directive (EU) 2019/1023 (n 31)

### 5.2.7. International Acceptance of the 'New' Company

There is little value in a process of reconstruction of international companies with global reach and stakeholders if the emergent entity, divested of the problems of the old and carrying new duties and obligations, is not recognised by foreign jurisdictions and binding on all. In the context of common market relationships which promote cooperation and comity between national jurisdictions, treaties will incorporate provisions for the courts of each signatory to recognise the orders arising from the proper conduct of the national legal procedures of each other. This is evidenced by the EU relationship from which the UK seeks to divest itself.

The KSA has, since 1981, been a member of the Gulf Cooperation Council (GCC) in the Middle East region. Its aim has been “development planning, economic management, trade and competitiveness, private sector development, governance, transport, energy, urban planning, land management, social protection and labour, health, and education”.<sup>48</sup> The inter-nation relationships are, however, fundamentally different from those of the EU, despite plans in 2011 to develop closer economic and legal ties.

Recognition is particularly important when corporate interests straddle diverse jurisdictions, but it is not a legislative commodity, simply an aim, and it is not possible to require foreign courts to accept rulings from outside their jurisdiction.<sup>49</sup> The risk when sanctioning reorganisation is that the original liabilities would be enforced in other jurisdictions.<sup>50</sup> The UNCITRAL Model Law on Cross-Border Insolvency 1997 and subsequent protocols recognised the need for “encouraging cooperation and coordination between jurisdictions” regarding orders which dealt largely with the demise of severely financially distressed or insolvent companies.<sup>51</sup> There is no requirement imposed of unification of substantive law although respect for the differences and the orders made in insolvency is asked for, so long as comity

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<sup>48</sup> The World Bank, ‘The World Bank in the Gulf Cooperation Council’ Council’ (The World Bank 1 September 2018) <<http://www.worldbank.org/en/country/gcc/overview>> accessed 20 September 2019.

<sup>49</sup> See *Avanti Communications Group Plc* [2018] 582 BR 603 (United States Bankruptcy Court, SD New York).

<sup>50</sup> See *Far East Capital Ltd SA* [2017] EWHC 2878 (Ch)

<sup>51</sup> UNCITRAL, ‘UNCITRAL Model Law on Cross-Border Insolvency’ (UNCITRAL 1997)

<[http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/1997Model.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html)> accessed 20 September 2019.

does not infringe national culture or values. Such a programme will be considered herein in accordance with the aim of examining the potential for the creation of a global scheme of arrangement regime.

#### 5.2.8. *Corporate Planning and Reorganisation*

The procedure as described and analysed in the context of the UK legal framework, which was also noted in the examination of other jurisdictions in subsequent chapters, aims to leave control over determination of corporate needs to management. This is based on the presumption that directors will act in the interests of the company and subject to the now broadly global governance principles of openness, transparency and accountability. It is perceived by Parliament and the market as a company management process rather than being specifically associated with financial distress and insolvency avoidance, as is the case with the KSA. This is not simply a relatively pedantic difference because in the juridical experience of mature schemes elsewhere much the same non-distress functions are made use of and may have a bearing on its attractiveness in terms of ‘forum shopping’.

#### 5.2.9. *Rationalisation of Corporate Structure*

In 2018, *Old Mutual Plc* sought advice from the High Court regarding its proposal for ‘managed separation’ before embarking on the de-merger of parts of the business which would affect member and creditor interests, some positively while others adversely.<sup>52</sup> Shares would be cancelled in the original company and reissued in the new emerging entity. Justice Snowden considered it “entirely sensible and appropriate” to examine the option by seeking judicial expertise.<sup>53</sup> This option of ‘pre-testing’ a scheme proposal before embarking on the related expense is a fine example of the value of a scheme and an experienced judiciary. It provides a lesson for the KSA courts in the value of assistance in effecting future economic stability. The emphasis, however, must be on responsible director control with judicial procedural oversight,

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<sup>52</sup> *Old Mutual Plc* [2018] EWHC 873 (Ch).

<sup>53</sup> *ibid* para 7.

which cannot include commercial guidance. It is for the authorities to determine legal compliance, not help run the company.

#### 5.2.10. Company Takeovers and Mergers

Chapter II noted how the scheme of arrangement is now a major choice of structural accommodation for the effecting of takeovers of other corporate entities, be they competitors or to facilitate entry into a new market. The target may indeed be a distressed company, but the impetus for the conduct of legal procedures lies with the stronger entity. This is apparent in the Flybe arrangement which was primarily undertaken for the benefit of Virgin and Stobart Airlines. It is a valued alternative to the other procedures of negotiation which are often fraught with tactical manoeuvring by internal, competing corporate interests and circumvention of others in ally fostering practices.<sup>54</sup> This need not mean everyone involved become friends, but the use of the scheme, it is suggested, has significant benefits in easing the processes of takeover and merger or assimilation, with improved reputational and coordinated outcomes. It avoids the more complex, administrative and time-consuming processes required by the Takeover Panel.<sup>55</sup>

This emphasises the importance of judicial monitoring of compliance. The courts have considerable experience in seeing through what is described as the purpose of proceedings and what is actually being effected. Chapter II notes on *Savoy Hotel Ltd*,<sup>56</sup> for example, that an arrangement will *prima facie* constitute a scheme and be subject to the statutory regulatory process, even where it was never intended to be a scheme of arrangement. This case dealt with a challenge to the nature of the negotiations which involved ousting the management of one of the companies. This constituted a takeover and would be dealt with as such, not simply as a

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<sup>54</sup> Ibne Hassan and Pervez Ghauri, *Evaluating Companies for Mergers and Acquisitions* (Emerald Group Publishing 2014) 22.

<sup>55</sup> See Section 2.4.2.

<sup>56</sup> [1981] Ch 351.

corporate convenience. The principles of reasonableness, transparency and fairness would be adjudicated upon by the court, not privately by the parties.<sup>57</sup>

Although adjudicated upon before the CA 2006, the decisions are indicative of the inherent value of experience and knowledge of how companies operate. This is an aspiration to be achieved by the KSA judiciary as the new company and bankruptcy law framework principles are embedded and used. Lessons will also be learned from the standards of protection for shareholders and creditors demanded by the City Code on Takeovers and Mergers, principally section 3(a) on transparency. Schemes of arrangement are to be termed as such if they are being used as the basis to effect a takeover.<sup>58</sup> This will activate the legislative supervisory procedure.

It was noted in Chapter V that companies in the KSA before the BL 2018 sought to make private, contractual-based arrangements. These tended to suit stronger vested interests at the expense of the weaker rights holders and inhibited their ability to enforce them. In this context, the scheme of arrangement moves outside of the realms of insolvency bringing a much needed formality to company law-based processes, increasing trust and attractiveness to investors. The court must approve the arrangement, not the parties.

#### *5.2.11. Brexit: Schemes of Arrangement and Adaptation to Commercial Imperatives*

It is clear from the research that companies must be adaptable to political change outside of their control. This was particularly evident with the advent of the global financial crisis of 2008 when companies struggled with the worst market downturn since 1929, the period thereafter being a proving ground for the flexibility of the multi-purpose scheme of arrangement.<sup>59</sup> In the UK the potential difficulties faced by corporations which trade in the international arena, incurring liabilities and responsibilities appear solvable by well-managed, perceptive planning by management, supervised and approved by the courts, before renewed entry to the market.

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<sup>57</sup> See also *Singer Manufacturing Co v Robinow* [1971] SC 11.

<sup>58</sup> Panel on Takeovers and Mergers, 'The Takeover Code' (2016) <<http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf?v=8Jan2018>> accessed 20 September 2019.

<sup>59</sup> Paterson (n 38).

Strategic considerations have been essential in preserving strength and market viability in the light of the decision of UK voters to exit from the EU, which for 40 years had opened trade links for business to the world.

In order to seek preservation of these relationships, and arguably survive the tariff consequences of this policy, financial institutions have moved some operations to those countries which will facilitate retention of their links. Barclays Bank and its subsidiary Capital Securities Ltd, it was noted in Chapter II, have transferred a substantial part of their private client investment service to their Ireland subsidiary.<sup>60</sup> Euroclear, another securities company, has moved its operations from London to Belgium.<sup>61</sup> Steris, an international pharmaceutical company and surgical equipment maker, has also chosen Dublin as its new home, offering a more stable business future than that provided by the UK.

Business does not thrive in political insecurity, but ardent Brexit supporters insist that a complete separation from an established European market will enable the UK to develop its own path to success although they do not explain how.<sup>62</sup> While awaiting Brexit developments and its consequential insularity, it is noted that advantage can be taken of the EU freedom of establishment principle by even the most fanatical of advocates.<sup>63</sup> It has been repeatedly postulated that the making of a 'deal' with the EU, any deal now apparently preferable to 'no deal' will stabilise business and companies, but there is nothing in the proposals of October 2019 which has any impact on the schemes of arrangement process, save the deregulation intention espoused. In a 'no deal' scenario however, there will be an end to the reciprocity of

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<sup>60</sup> Harry Wilson, Stefania Spezzati and Alexander Weber, 'Barclays May Transfer 5,000 Clients to Ireland in \$217 Billion Brexit Move' (Bloomberg Business, 30 January 2019) <<https://www.bloomberg.com/news/articles/2019-01-30/barclays-may-transfer-5-000-clients-in-217-billion-irish-move>> accessed 20 September 2019.

<sup>61</sup> *Euroclear Plc* [2018] 11 WLUK 273.

<sup>62</sup> Attracta Mooney, Owen Walker and Chris Flood, 'Fund Founded by Rees-Mogg Sets up Post-Brexit Vehicle in Dublin' (Financial Times 13 June 2018) <<https://www.ft.com/content/38987fe2-6f19-11e8-92d3-6c13e5c92914>> accessed 20 September 2019.

<sup>63</sup> Kathy Stones, 'Brexit Prompts Transfer of Company Assets to Ireland (Re Steris plc)' (LexisNexis 30 April 2019) <[https://www.lexisnexis.co.uk/blog/restructuring-and-insolvency/brexit-prompts-transfer-of-company-assets-to-ireland-\(re-steris-plc\)](https://www.lexisnexis.co.uk/blog/restructuring-and-insolvency/brexit-prompts-transfer-of-company-assets-to-ireland-(re-steris-plc))> accessed 20 September 2019.



recognition of scheme and bankruptcy orders.<sup>64</sup> This will considerably reduce the attractiveness of the UK jurisdiction to international business for its restructure needs.<sup>65</sup> The situation is in a state of considerable flux. To expand upon this would be entering into a realm of speculation, and its effect is a matter for further study when something actually happens.

### **5.3. Chapter III Jurisdictions: Comparison with the UK and Lessons Learned**

Chapter III focused on flexibility, efficiency and the balance of fairness and reasonableness in the interests of all parties involved in the restructuring to assist in evaluation of the viability of the scheme in the KSA business structure, culture and market. In order to investigate how the use of schemes of arrangement may impact on the KSA, eight other jurisdictions were examined in Chapter III.

#### **5.3.1. Transplantation: Adoption of Laws by Other Jurisdictions**

The concept of transplantation of laws and procedural frameworks between nations with diverse cultural histories and socio-economic values was introduced in Chapter I. Pluralist thinking considers there to be problematic gaps, even in a globalised economic interactive network, made up of what Snyder calls “an aggregate of multifaceted, uneven, often contradictory economic, political, social and cultural processes”.<sup>66</sup> The simple adoption of a legal framework from another system will not take account of the traditions and principles, even linguistic differences, which govern the law in the recipient jurisdiction. This is particularly pertinent where political systems are not capable of comparison, an issue which is evident in

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<sup>64</sup> UK Business, Energy & Industrial Strategy and Ministry of Justice, *Handling civil legal cases that involve EU countries if there's no Brexit deal* (13 September 2018) <<https://www.gov.uk/government/publications/handling-civil-legal-cases-that-involve-eu-countries-if-theres-no-brexite-deal/handling-civil-legal-cases-that-involve-eu-countries-if-theres-no-brexite-deal>> accessed 20 September 2019.

<sup>65</sup> Edward Downer and Howard Morris, ‘European Union: How The UK Government's "No Deal Brexit" Planning Impacts Cross-Border Restructuring And Insolvency In The UK’ (Mondaq 16 November 2018). <<http://www.mondaq.com/uk/x/755282/Insolvency+Bankruptcy/How+the+UK+Governments+No+Deal+Brexite+Planning+Impacts+CrossBorder+Restructuring+and+Insolvency+in+the+UK>> accessed 20 September 2019.

<sup>66</sup> Francis Snyder, ‘Global Economic Networks and Global Legal Pluralism’ (European University Institute 1999) 6 <[https://www.peacepalacelibrary.nl/ebooks/files/law99\\_6.pdf](https://www.peacepalacelibrary.nl/ebooks/files/law99_6.pdf)> accessed 20 September 2019.

the distinction between a Western democracy, such as the UK and other jurisdictions studied, and a Middle Eastern monarchy, the KSA.

The assessment of the evidence to support a further aim of the study, namely the extent to which the UK scheme of arrangement legislation and case law proved globally influential and effective, does indicate some impact but it is not beyond reasonable challenge or doubt. The UK judiciary has arguably given more leadership in interpretation of legislation and satisfaction of the diverse needs of companies and associated interests on the subject of their survival or demise. This is a product of respect arising from a history and reputation of independence and impartiality.

It is suggested that global commerce is somewhat separated, even disconnected, from the social and traditional culture of a state, which is a perspective which Watson considers bridges transplantation gaps.<sup>67</sup> Good examples and advice cannot of themselves be considered evidence of transplantation; it is simply good practice to adopt and adapt best practice to cultural needs. In a globalised commercial market filled with diverse business structures, essential principles of governance and the need for corporate adjustment and survival are universal. The similarities of the schemes of arrangement, which facilitate organisational flexibility and adaptability across the jurisdictions examined, are not simple indications of transplantation or indeed replication. Indeed, it is argued that, in order for the KSA to prosper, the changes envisaged by its Vision 2030 initiative must accommodate diversity. Business is not separated from government and societal values, and company management is predicated on the standards expected of society and, in the case of the KSA, the *Shari'a*. It was asserted in Chapter IV that international values of probity reflect those of *Shari'a* law. There are certainly financial restrictions imposed in practice but it is argued that the ubiquitous needs of commerce are served in an internationally recognised process incorporating religious values rather than simply moving a body of law from one culture to another.

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<sup>67</sup> Alan Watson, *The Evolution of Law* (Blackwell 1985) 110.

### 5.3.2. *Similarity of Schemes is not Indicative of Successful Model Creation*

The Chapters III and IV comparison with the UK procedures shows the schemes are similar. This in theory indicates the potential to create a global scheme of arrangement regime, that is, a 'Model' which could be shared in the interests of promoting global comity. The transplantation discussion, however, indicates that nations will adopt practices and procedures which are relatively simple for the company and courts to adapt and operate but each will still have its own economic, political and social imperatives to maintain and protect. Sovereignty is jealously guarded by nations because it is seen as a measure of national governmental control over the laws and fate of a national territory.

The UNCITRAL insolvency recognition Model does not demand change in the law of its signatories "encouraging cooperation and coordination between jurisdictions, rather than attempting the unification".<sup>68</sup> It does not even suggest comity, but simply respect. The EU Preventive Restructuring Directive 2019/1023 requires members of the Union to harmonise their laws, ensuring application and recognition in its unified market area.<sup>69</sup> This does not constitute a Model of procedure but is suggestive of the fact that where political and economic will and enforceable obligations exist, a list of requirements may be the best that can be expected to serve corporations. Nevertheless, the law must serve the interests of a nation, not simply the needs of global corporations. Business serves the state, not *vice versa*. There can be no 'ideal' to fit all economic needs.

### 5.4. *The Future of the KSA Schemes and Corporate Restructure*

This research has been conducted to examine the operation of schemes of arrangement in diverse jurisdictions with contrasting histories and legal traditions. Chapter IV examined the foundations of culture, religious imperatives and governmental structure of the KSA, markedly

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<sup>68</sup> UNCITRAL (n 51) Purpose.

<sup>69</sup> Robert Paterson, 'The EU Council May be Preoccupied with how and when Brexit Takes Effect, but the EU Parliament Continues to Produce New Legislation' (Moon Beaver 2 April 2019) <<https://www.moonbeever.com/comment/eu-parliament-approves-eu-restructuring-directive>> accessed 20 September 2019.

different to its international partners. The economy has hereto been predicated on a single, finite source of wealth which has enabled the Kingdom to play a prominent role with considerable authority in the world markets.

In the context of the former Saudi legislation, Habib and Abidin argued that private enterprise hardly featured in the economic profile, and certainly not until admission to the WTO started to attract foreign investment.<sup>70</sup> This created a demand for fundamental reform of the law to adapt to the diverse needs that are now expressed with some urgency in the Vision 2030 initiative.

Chapter IV gives a detailed assessment of the economic, commercial and legal background in which there is a need for change whilst maintaining the cultural imperatives of religion and tradition. The chapter further highlighted in substantial detail how the other restructuring mechanisms became unfit for purpose given the size and complexity of today's enterprises. The 1996 legislation lacked transparency and clarity, and arguably fairness and reasonableness, given the level of state control and the custom of reaching personal, private solutions to address immediate problems rather than seek long term viability solutions for business operations. Immersed in an idiosyncratic, multi-jurisdictional and state-based legal system, there was little incentive in the SABL 1996 for entrepreneurs to take business risks, facing, as they did, an unmanageable bureaucracy of inconsistent regional practices.<sup>71</sup> Bankruptcy was mostly caused by incompetence or dishonesty, not market fluctuations or business cycles of success and threat.<sup>72</sup>

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<sup>70</sup> Ghazi Habib and Adnan Abidin, 'Bankruptcy of Saudi Corporations: The Causes and Resolutions' (1987) *Arab Journal of Management* 152, 154.

<sup>71</sup> Royal Decree No M/16 of 04/09/1416 (24/01/1996) and see Rayed AlGhamdi and others, 'Factors Influencing E-commerce Adoption by Retailers in Saudi Arabia: A Quantitative Analysis' (2012) 3 *International Journal of Electronic Commerce Studies* 83.

<sup>72</sup> Mohammed Bader, 'Causes of Contractors' Failure in Saudi Arabia' (King Fahd University of Petroleum and Minerals, Report CEM 520, December 2004) <[http://faculty.kfupm.edu.sa/CEM/assaf/Students\\_Reports/Causes-of%20Contractors-Failure-in.pdf](http://faculty.kfupm.edu.sa/CEM/assaf/Students_Reports/Causes-of%20Contractors-Failure-in.pdf)> accessed 20 September 2019.

#### 5.4.1. *The Bankruptcy Law 2018*

In accordance with the liberalisation of trade demands of WTO membership, and more importantly the KSA need to diversify its economy to reduce and end reliance on its finite sources, the KSA government modelled its National Transformation Plan 2020 (NTP 2020) and Vision 2030. These are examined in Chapter IV but it is worthy of note here that the NTP 2020 emphasises the need to “develop and implement regulations and processes that remove hurdles to start, run, develop and exit a business, and provide needed protection to businesses, that is contract enforcement, insolvency and shareholders protection”.<sup>73</sup> Vision 2030 places emphasis on employment, the growth of a vibrant, private business sector, increased foreign and domestic investment, and a user-friendly corporate legal environment.<sup>74</sup> Herein lies, at least in part, the impetus for the New Bankruptcy Law.<sup>75</sup>

This research commenced before the BL 2018 was approved, but the law has now been published. In late 2018 and early 2019, the KSA courts adjudicated on the first scheme, which were about the bankruptcy management of the enormous, multi-national conglomerates of the Saad Group and AlGosaibi Brothers. These had been trying the patience of the judiciary for over a decade. Although the aim of the BL 2018 is described in terms of bankruptcy management, liquidation is noted as a last resort.<sup>76</sup> Advantage is now being taken of the potential for rescue of two monoliths central to the Saudi economy, albeit subject to the markedly stricter disclosure demand of the new legislation.

The novelty of the new law raises issues and difficulties in the evaluation of the law in the context of the aims of this study in answering the objectives and questions. These, it will be

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<sup>73</sup> Saudi Arabia National Transformation Programme 2020 ‘Delivery Plan 2018-2020’ Objective 3.1.1. <[https://vision2030.gov.sa/sites/default/files/attachments/NTP%20English%20Public%20Document\\_2810.pdf](https://vision2030.gov.sa/sites/default/files/attachments/NTP%20English%20Public%20Document_2810.pdf)> accessed 20 September 2019.

<sup>74</sup> Altamimi & Co, ‘The New Saudi Arabian Bankruptcy Law’ (Altamimi & Co March 2018) 307 Law Update <<https://www.tamimi.com/wp-content/uploads/2018/04/Law-Update-March-Edition.pdf>> 20 September 2019.

<sup>75</sup> Royal Decree No M/05 of 28/05/1439 (13/02/2018).

<sup>76</sup> Zahi Y Younes, ‘Saudi Arabia Issues its First Developed Bankruptcy Law’ (Baker McKenzie 5 March 2018) <<https://www.bakermckenzie.com/en/insight/publications/2018/03/saudi-arabia-first-developed-bankruptcy-law>> accessed 20 September 2019.

recalled, are (i) determining the feasibility of its engagement in transnational business operations while remaining compliant with *Shari'a* principles and (ii) considering the extent to which the KSA's restructuring mechanisms and its newly adopted scheme of arrangement adopting *Shari'a* law principles stand in opposition to schemes of arrangement and other restructuring mechanisms used in the West.

Answers were sought in the detailed description, analysis and comparison undertaken in Chapter IV. It was determined therein that *Shari'a* principles simply reflect corporate governance requirements of probity, transparency and fairness, and considerably more emphasis is placed on the protection of all creditors, not simply those who shout loudest or are best connected. There is little doubt that the new procedural regime represents a more modern insolvency regime than its disjointed predecessor,<sup>77</sup> with a clarity in priority which reflects both Western schemes and the principles of *Shari'a*, and being overseen by a judiciary growing in expertise and commercial wisdom.

Chapter IV meets the primary aim of this research of explaining how the BL 2018 offers a more flexible and efficient means of restructuring large corporate enterprises whilst balancing fairness and reasonableness in the interests of all parties involved in the restructuring through its financial reorganisation and protective settlement procedures. These, however, are yet to be tested in the courts, so theory and legislative evaluation rather than practice are the foundation of this conclusion. Althiabi explained that *Shari'a* principles of honesty, fairness, good intentions, just dealing and understanding<sup>78</sup> were emphasised by the SABL 1996. It was argued in Chapter IV that these remain embedded in the BL 2018, which should not be seen as a consolidation of the SABL 1996 but as vibrant, revitalised process offering considerable promise for the diverse KSA economy of the future.

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<sup>77</sup> Grahame Nelson and Mohammed Negm, 'The New Saudi Arabian Bankruptcy Law' (Altamimi & Co 30 March 2018) <<https://www.tamimi.com/law-update-articles/the-new-saudi-arabian-bankruptcy-law/>> accessed 20 September 2019.

<sup>78</sup> Saad Althiabi, 'The Priceable of Good Faith in Saudi Law: A Comparative Study with Other Laws' (2014) 23 *Journal of Sharia, Law and Islamic Studies* 15 <<http://dspace.iua.edu.sd/handle/123456789/347>> accessed 20 September 2019.

The services of the KSA courts are offered to “individuals and corporations carrying on commercial, professional or for-profit businesses in the Kingdom of Saudi Arabia” and non-Saudi investors with assets in the country or conducting business through another party in the country.<sup>79</sup> This *prima facie* meets the commercial and economic imperatives of the Vision 2030 initiative, which are to attract foreign corporations and develop and protect domestic entrepreneurship in the Kingdom. These are encouraged through a rescue and restructure priority embedded in the BL 2018, promoted by a moratorium to protect companies facing financial distress.<sup>80</sup> In this provision, the law exceeds the protections for the company at risk to a greater extent than the current UK scheme.

#### 5.4.2. Reorganising and Refinancing

The focus of this study is on the comparative law of corporate restructure in times of growth, distress, decline and demise, with particular emphasis on UK legislation, its influence on the international principles of rescue and rehabilitation, specifically on the KSA law. Although not a subject within its remit, some attention should be given to the refinancing of distressed companies. These enterprises are already in considerable debt to the extent that their parlous circumstances threaten their existence and the investments of existing creditors and members. The option of ‘borrowing more’ is not an appealing prospect for the proposed new lenders, and whilst western capitalism will demand an interest-laden premium, this is not an option available in *Shari’a* finance which prohibits *riba* and condemns unjust enrichment.

The EU Preventive Restructuring Directive 2019/1023 highlights the need for government and private banking facilities to provide a foundation for rehabilitation from financial distress.<sup>81</sup> There is no encouragement of government intervention in the promotion of private financial provision, and indeed a practical, state-run framework would be contrary to the rules of competition in all international treaties. Restructuring companies must therefore depend on the private providers of funding such as banks and venture investors. This requires, it is

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<sup>79</sup> Nelson and Negm (n 77).

<sup>80</sup> Article 46 and see also the Implementing Regulations of the Bankruptcy Law, No 4744, 1439 (2018) 4.

<sup>81</sup> Directive (EU) 2019/1023 (n 31)

suggested, a mature financial market which the KSA needs to develop. However, the creditor compromise issues inherent in a corporate restructure, rearrangement and refinancing scheme have caused some concerns in answering the research question of the extent to which *Shari'a* law stands in opposition to schemes of arrangement and the other restructuring mechanisms. The issues were considered in some detail in Chapter IV, but for the purposes of this discussion the importance of full satisfaction of creditor interests and debt are emphasised here.

Companies in financial distress must seek restructure of liabilities and debt in order to preserve a future trading capacity through which they can be repaid. *Shari'a* requires a mutuality of cooperation between debtor and creditor, and this is facilitated by the moratorium allowing breathing space and time, which enables companies with viable business operations to service debts.<sup>82</sup> This is no longer private adjustments and agreements made to suit immediate needs but is now a court-monitored process involving all interested parties in the financial future of the corporation. This transparency and oversight is noted in all the schemes examined; they are particularly pertinent to the demands of *Shari'a*. The analysis of the BL 2018 in Chapter IV therefore provides clear evidence of the compatibility of secular and *Shari'a* requirements.

The primary concern of the scheme is not so much with member-shareholder interests but with creditors in the restructure process. Some reliance has to be placed on the anticipated value and compatibility of reorganisation with the statement of rescue imperatives because the KSA has limited experience of international legal application, accommodation and management of strategic structural planning, takeovers and mergers.<sup>83</sup> There is considerable comment in Chapter IV regarding issues of refinancing and the availability of funding from private sources to facilitate survival and continuation, although 'working capital' is the essential 'lifeblood' of any business.<sup>84</sup> In terms of rescue and future needs, the financial system is not accustomed to the traditional western capitalist modes of interest-based lending in contexts of *prima facie* high

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<sup>82</sup> Younes (n 76).

<sup>83</sup> Rehana Parveen and Emna Chikhaoui, 'Theoretical Framework and Analysis of New Bankruptcy Regulations in Saudi Arabia' (2018) 3(1) International Journal of Applied Economics, Finance and Accounting 10, 13.

<sup>84</sup> Simon Calver, *Success the LOVEFilm Way: How to Grow a Fast Growth Business in Fast Changing Times* (John Wiley and Sons 2013) Ch 1.



risk. Indeed, *riba* is prohibited. It remains to be seen what policies and initiatives are introduced or supported by the government until the satisfaction of this particular need occurs.

### **5.5. Conclusion**

The KSA is fundamentally different in history, culture and governance from those jurisdictions examined in this study yet it appears to have adopted and adapted legislation that meets global corporate standards, needs and obligations. It is not suggested that companies should be treated differently or as a special case by diverse national cultures, but economic imperatives of the encouragement of private business, entrepreneurship and international finance can be achieved without religious compromise. Following several years of legal study of corporate law and global practice, pursuant to the Vision 2030 reform initiative, it has recognised the value of the scheme of arrangement as a more coherent and internationally-attractive way of providing services vital to corporate adaptability. This chapter has drawn on a comparison with other nations which share similar mechanisms of corporate reform, restructure and reorganisation, in the contexts of liquidation, distress or indeed expansion.

The scheme of arrangement is not so much a product of generic transplantation from one country to the next, despite historical relationships with the UK as a source of principles if not legislation. It is more reflective of the global needs of business, which are universal, and points to the requirement for a home jurisdiction which will meet individual, flexible and adaptable business, commercial and legal needs. The KSA has joined the pantheon of nations vying for the attention of international business. It is the latest recruit to the scheme of arrangement providers and, given the novelty of the New Bankruptcy Law and the limited jurisprudential experience to draw upon, recommendations for adjustment or alteration would be verging on the impertinent. Suggestions have been made for the improvement of schemes of arrangement in general application throughout the study in the context of seeking a 'Model'. Here, the author must assert the potential for bias in reflecting that the BL 2018, evaluated and assessed in Chapter IV, without yet being tested in the courts, comes close to the requirements of a theoretical ideal, if not a practical one. The KSA has managed to enact a court-overseen procedure for companies which emphasises the need for protection of creditors, based upon

*Shari'a* relevant principles, that is adaptable enough to deal with the substantive needs of business. Now it simply needs to show that it works.

In the introduction to the research questions in Chapter I, it was noted that the study proposed to address the possibility of creating an international scheme of arrangement to respond to the flexibility demanded by the volatile global market, thus facilitating corporate rescue and stability in national and international economies.<sup>85</sup> It is certainly the case that freedom of trade and the fluidity of national borders has promoted globalisation and, in a sense, a high level of control in international politics and change through multinational conglomerates wielding considerable political power. However, this does place the role of the company executives in positions of authority which many governments will resist. It is one purpose to facilitate economic growth with a legal framework adaptable to the needs of its major providers for the good of the nation and the welfare of its people. It is another matter to effectively cede control and influence to a business enterprise whose primary purpose is profit. It is a profound compromise of the national sovereignty of any adopting state.

The research has sought to answer the questions set in Chapter I<sup>86</sup> and to meet the objectives of the study by highlighting how schemes of arrangement do provide an effective, flexible alternative to more single focus restructure procedures. In the objectives noted in Chapter I,<sup>87</sup> it was suggested that companies may be less inclined to use relatively new procedures where the old tried and tested methods of, for example, debt restructure negotiation, organisation of takeovers and mergers may be of more appeal. The research has shown, however, that the well-defined features of schemes of arrangement have proved an attractive alternative.

The primary research question asked, *with particular reference to the UK, the KSA and other selected jurisdictions, to what extent do schemes of arrangement provide an effective alternative to other restructuring tools available under corporate law*, has been answered in considerable detail throughout. It is evident from the focus of the study that schemes are under

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<sup>85</sup> See Chapter I, 1.1.

<sup>86</sup> See Chapter I, 1.10.

<sup>87</sup> See Chapter I, 1.10.3.

regular review by national legislatures which seek improvements to the process through readjustment of company-creditor protection balance, the availability of the moratorium, and amendment to voting requirements. The law cannot be perfect or static. It too must evolve, its interpretation adapting to particular needs and problems. Schemes of arrangement have had their potential and actual operation in the diverse jurisdictions clarified.

In the context of the Saudi BL 2018, it is arguably too early in its application and effect to determine how it can be changed to meet developing needs. It will alter, but that very much depends on the way it operates, the interpretation of the judges, and the experience of the companies seeking its jurisdiction. It has been drafted and enacted based upon best international practice, commensurate with cultural principles. The most pressing need is perhaps a method of re-financing in times of distress which does not compromise the Islamic finance principles. The substantial change has ensured that although international procedures and principles have been adopted, the Decree still retains the application of the *Shari'a* framework. It has been instructive to note that practices of fairness, transparency, provision of support and creditor protection in the jurisdictions evaluated bear some considerable resemblance to the Islamic principles.

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