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Schemes: Flexibility and Familiarity

Reasons for using a Scheme of Arrangement for BVI corporate transactions

The Scheme of Arrangement ("Scheme") has been a feature of English law since the mid-19th century and has been in its current form since 1908. Its effectiveness and adaptability are recognised in the fact that the UK model has been adopted in legislation around the world and, as such, is a tested tool, familiar to corporations globally. The Scheme has been a feature of British Virgin Islands law since 2006[1] and has extended the range of options available to companies under the BVI Business Companies Act 2004 (the "BCA"), already known for its flexibility and utility. Perhaps because of the stage of the economic cycle at which it was introduced, the principal use of Schemes in the BVI to date has been in the context of corporate insolvencies. The invaluable role which Schemes can play in restructuring debt is well documented. The use to which Schemes may be put to use by BVI companies other than in insolvency is perhaps less well-known and is worth highlighting. This short article is written with that aim.

The Scheme is a valuable mechanism which permits a company to enter into a binding compromise or arrangement with its members or creditors, or any class of them, respectively, without entering into separate contractual arrangements with every individual which it wishes to bind. With the consent of the relevant class or classes of members or creditors and the sanction of the Court, all of the relevant members or creditors with whom the arrangement was proposed will be bound by the terms of the Scheme, whether or not they voted in favour of the Scheme. This allows the company to reorganise or restructure within a commercial timeframe and with a degree of certainty of outcome which would generally be unavailable if it needed to negotiate and to reach agreement separately with every interested party. It

[1] The BVI Business Companies (Amendment) Act, 2005 which inserted new section 179A into Part IX of the BVI Business Companies Act 2004 came into force on 1 January 2006.

also permits complex, multi-level restructurings, where different classes of members or creditors are dealt with in different ways. This can even include, in appropriate cases, allowing individual members or creditors to choose between different forms of consideration or settlement.

To fall within the scope of the statute, the proposed Scheme must constitute "a compromise or arrangement... between the company and its creditors, or any class of them, or between the company and its members, or any class of them…" Whilst the word "compromise" presupposes some dispute about rights or difficulties in enforcing them[2], an "arrangement" is not so confined[3]: all that is required is that there should be some element of give and take between the parties[4] and that the company itself should be party to and approve the Scheme[5].

The breadth of possibilities which are capable of falling within this definition means that the list of circumstances in which a Scheme might be used is not closed and continues to evolve. So, for example, in recent years, Schemes have been used by Insurers facing long-tail claims to cut-off such claims and by companies facing long-term liabilities arising from industrial injuries to ring-fence those claims, allowing the companies to continue to trade. More novel uses and applications of the Scheme jurisdiction will undoubtedly emerge in due course. More conventionally, Schemes have become the means of choice for companies effecting recommended takeovers in both the UK, Australia and elsewhere and for Cayman Islands companies listed in Hong Kong, both in share for share, cash only, combination and mix and match bids. Acquisitions are a good example of where the BVI legislation might be better understood and more used[6]. Similarly, mergers and demergers, whether in preparation for a listing or as part of the ordinary course of corporate strategy, can also be effected via a Scheme. A Scheme can also be used as a means of effecting a corporate migration whether into or out of the BVI, where the provisions of Part X of the BCA which allow for continuation into the BVI are not available, and as a means

[2] Mercantile Investment and General Trust Co-v-International Co. of Mexico [1893] 1 Ch 578 and see also In re Alabama, New Orleans, Texas and Pacific Junction Ry Co [1891] 1 Ch 213 - "What is a compromise? An arrangement between two parties by which they both make concessions and give up something".

[3] Re Guardian Assurance Co. [1917] 1 Ch 431, Re NFU Development Trust Limited [1973] 1 ALL ER 135, Re T & N and others (No 3) [2007] 1 BCLC 563 at 586.

[4] Re NFU Development Trust Limited [1973] 1 ALL ER 135, Re Equitable Life Assurance Society [2002] 2 BCLC 510.

[5] Re Savoy Hotel Ltd [1981] Ch *351* and also Validus Holdings Ltd v. IPC Holdings Ltd and Max Capital Group Ltd [2009] Supreme Court of Bermuda (Commercial Court) Ground CJ.

[6] Although the requirement that the Company consent to the Scheme means that it may not be used in a hostile takeover: Re Savoy Hotel Ltd [1981] Ch *351* and also Validus Holdings Ltd v. IPC Holdings Ltd and Max Capital Group Ltd [2009] Supreme Court of Bermuda (Commercial Court) Ground CJ.

of inserting a new holding company as a preparation for a listing or for other purposes. It can also be used to facilitate complex returns of value to shareholders and can be of particular use when it is intended to give members a choice as to the type and timing of a distribution of value.

Of course, the BCA already contains provisions[7] which allow for mergers and consolidations[8] and for the squeeze out of minority shareholders[9]. It also contains, in section 177, the near relative of the Scheme, in the form of the Plan of Arrangement. The Plan of Arrangement can be used amongst other things, to effect corporate reorganisations and reconstructions and the direction the Court will usually make will not require the approval of the enhanced majority, namely the majority in number representing 75% in value, which is a prerequisite for the Court to have jurisdiction to sanction a Scheme.

Why then, given this cornucopia of options, would a company choose to proceed by way of a Scheme rather than one of the other routes available to it to achieve the same object[10]?

The principal advantage which the Scheme enjoys over other options available under BCA Part IX is that section 179 of the BCA does not apply where a Scheme is approved. Section 179 confers an entitlement on any dissenting member of a company to payment of the fair value of his shares. If a member exercises his rights under section 179, the company must implement a procedure directed to establishing the price to be paid for the shares held by dissenting members. In the worst case, that process may involve an appraisal of the fair value of the relevant shares by three appraisers, a process which may be both lengthy (as long as 90 days from the date of the vote) and costly and one whose outcome is uncertain. By contrast, a Scheme sanctioned by the Court under section 179A binds all the relevant members or creditors with whom the arrangement was proposed, whether or not they voted in favour of the Scheme. No right to compensation arises outside the terms of the Scheme itself.

The great virtue which results from this is that a Scheme of Arrangement provides a certainty and finality which a Plan or a statutory merger or squeeze out may lack. Of course, in the case of a Plan, the Court may exercise its discretion to disapply the

[7] in Part IX
[8] Ss170-174
[9] S176
[10] It may be worth pointing out that the fact that the legislation supplies an alternative mans of achieving the same object does not mean that it is inappropriate to use a Scheme: Re BTR plc [1999] 2 BCLC 675

provisions of section 179. However, in all but the simplest cases, this imposes a high evidential burden as to the adequacy of the consideration being offered and the fairness of the Plan generally, a burden which needs to be discharged at an early stage in proceedings. As with the Scheme, the initial Court hearing before the Court is almost invariably ex parte and that fact places a strict duty upon the Applicant to place before the Court *all* material facts, whether in favour or against the relief which is sought[11]. It follows that those proposing a Plan cannot be certain from the outset when and on what terms the Plan will take effect.

By contrast, in the case of a Scheme, although the Court always retains a discretion to withhold sanction if it considers there to be "a blot" on the Scheme[12] (a discretion which has almost never been exercised), if the members or creditors properly consulted and acting bona fide approve the terms, the Court will be slow to depart from the judgment of the meeting. That being so, it is possible in the case of a Scheme to be certain as to the date upon which the transaction, if approved by the meeting, will take effect and it is the invariable practice to include an indicative timetable in the preliminary announcement as well as in the circular setting out the terms on which the Scheme is proposed.

In addition, section 179A(4) vests complete control over the point at which a Scheme takes effect once it has received sanction, in the hands of those propounding it. Under section 179A(4) a Scheme takes effect when the Order of the Court which sanctions the Scheme is filed with the Registrar of Corporate Affairs. That is obviously a matter which lies entirely with those doing the filing, generally the company or its advisers. By contrast, a Plan takes effect only when the Registrar of Corporate Affairs registers the articles of arrangement. Whilst the Registry is efficient and endeavours to effect a same day turnaround, this places an additional element of uncertainty as to the exact timing of events, timing which it may be critical to be able to ascertain with precision, particularly if the shares of the company concerned or, where a takeover is involved, those of the bidder are listed. The control over timing which the Scheme provisions of the BCA confer in such a case is therefore to be considered as a significant additional advantage a Scheme has over a Plan in such instances.

These two factors, taken with the long service record the Scheme jurisdiction has worldwide which give it precedents and familiarity, mean that the Scheme of

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[11] R v Kensington Income Tax Commissioners [1917] 1 KB 486 at p.504.

[12] The phrase derives from Re English, Scottish and Australian Chartered Bank [1893] 3 Ch 385 at 409, 62 LJ Ch 825, per Lindley LJ and was defined by Vos J in Halcrow Holdings Ltd [2011] EWHC 3662 (Ch) as meaning something unlawful or inappropriate.

Arrangement deserves to be used increasingly in the BVI to facilitate corporate transactions in the same way that it has come to be used in the UK and elsewhere.

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This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.

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