

Fiji Institute of Accountants

Webinar

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Navigating Schemes of Arrangement

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Why discuss creditors' compromises at all?

- many of your counterparties (or your own businesses) may be under financial pressure on account of current events
- schemes of arrangement are used (elsewhere) for possible “corporate workouts” to avoid business collapses and try to ensure fair outcomes in insolvent situations – not so much in Fiji
- how effective could they be here?



Covering

- Schemes of arrangement
- What is a creditors' compromise?
- When a creditors' compromise may be a better solution
- Steps involved in a creditors' compromise
- Common creditors' compromise schemes
- Advantages and disadvantages of a creditors' compromise scheme
- Challenges



Current situation

Pacific Trade Invest's Pacific Business Monitor (April 2021):

- The extent and severity of COVID-19 on Pacific businesses has increased, with 84% reporting a negative impact.
- 85% of businesses reported a decline in revenue due to COVID-19.
- 58% are confident that their business will survive the COVID-19 crisis.
- The top three challenges facing businesses are:
 - not knowing how long the crisis will last
 - impact of closed international borders
 - poor cashflow
- The top two initiatives businesses required assistance with were:
 - financial support (59%)
 - review financial position (35%)

What has happened elsewhere

- Moratorium for directors' personal liability for insolvent trading (Australia)
- Debt hibernation (New Zealand)
- Increase in the length of statutory demand to six months (Singapore)
- Winding-up action can only be filed if the “coronavirus test” is passed (UK):
 - o reasonable grounds for believing that coronavirus has not had a financial effect on the company or
 - o that the debt issues would have arisen anyway, regardless of the impact of the pandemic.

Traditional approaches

Traditional (and common) approaches to debt recovery against companies:

- **Winding-up application**

A company is solvent if it is able to pay all its debts as and when they become due and payable.

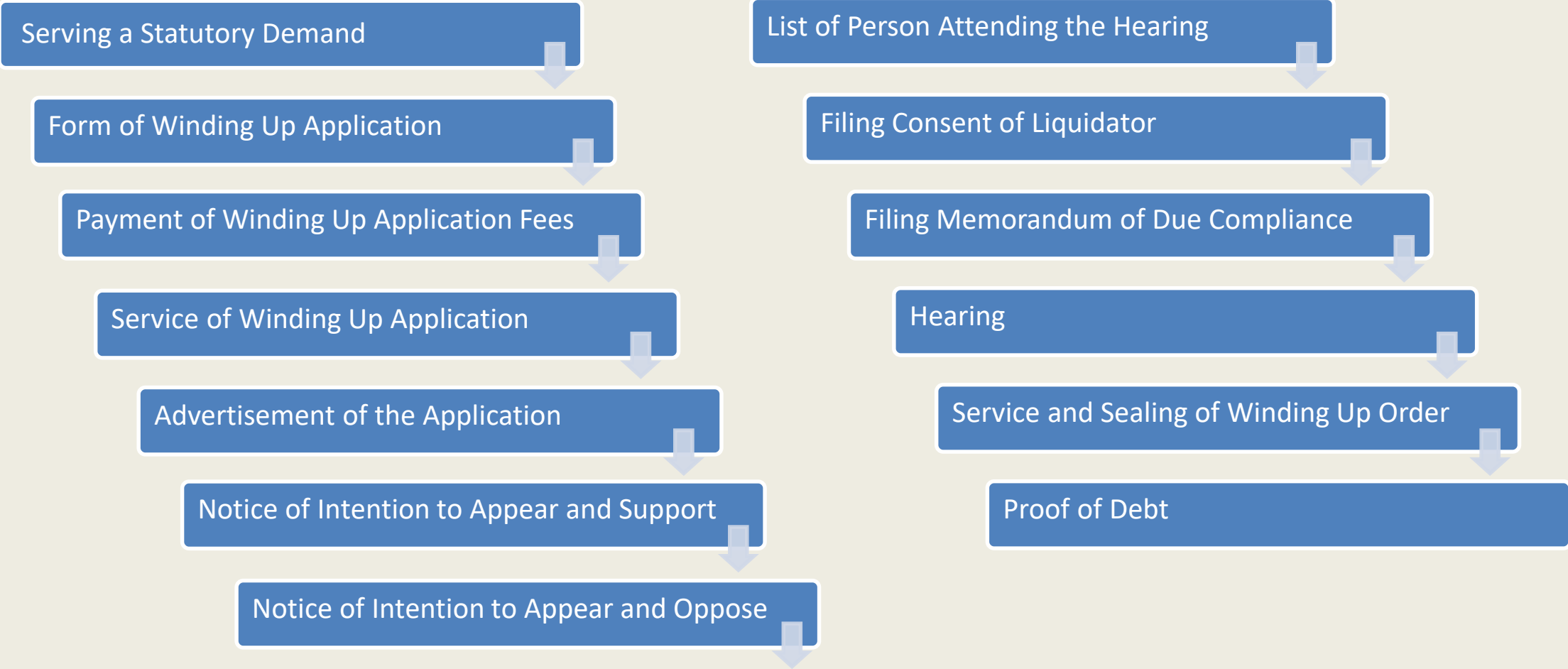
A company is deemed to be unable to pay its debts if a demand, for an [undisputed] sum in excess of \$10,000, remains unsatisfied for a period of three weeks.

- **Appointment of receivers/managers**

Generally used by creditors under security agreements (typically banks, finance cos holding mortgages)

The Court can appoint receivers but this solution is rarely used

Steps in a winding-up



Schemes of arrangement

- **Section 473, Companies Act 2015**

A compromise or arrangement between a company and its creditors/members or any class of them

- **Possible uses:**

- amalgamations
- demergers
- interposing a non-operating holding company
- reconstructions and
- “compromises with creditors” (*our focus today*).



Creditors' compromise

One form of “scheme of arrangement” (typically what a scheme is understood to be)

- An agreement between a company and its creditors
- Aim can be:
 - to enable a company to trade out of its financial difficulties, thereby avoiding receivership or liquidation or
 - orderly winding-down or liquidation which avoids “fire sale” and maximises returns for creditors
- Compromise agreement can be for almost any purpose e.g:
 - to exit onerous contracts
 - repay creditors less than what they are owed, and/or
 - pay creditors over a period of time.

When a creditors' compromise may be better

- company viable but has incurred losses and built up creditors due to a one-off event
- company affected by events but expected to recover once the events pass (eg. COVID-19)
- company's assets are insufficient to cover all debts/claims in the event of a liquidation
- company has good relationship with key creditors
- company has key contracts that need to be protected and other restructuring tools (e.g. voluntary administration) could trigger an event of default
- no immediate threats from creditors and/or statutory bodies to put the company in liquidation and
- private restructuring process is preferred.

May be a “bet” for creditors.

Steps (1)

Notice to the Registrar of Companies
(with draft explanatory statement)



Application to Court [Petition]
(to order a meeting of creditors)



Order of the Court
(for creditors meeting)



A statement— (a) explaining the effect of the proposed compromise and, in particular, stating any material interests of the directors and (b) setting out information that is material to the making of a decision by a creditor whether or not to agree to the proposed compromise.

Steps (2)

Voting Scenario:
Assume a company had debt of \$1million held by 30 creditors. If 20 creditors holding \$800,000 of debt vote at the creditors meeting, what are threshold requirements?

The Court must not approve a compromise unless there is produced to the Court a statement in writing by the Registrar stating that the Registrar has no objection to the compromise

Notice of Creditors' Meeting
(with explanatory statement)



Meeting of the Creditors



The compromise is agreed to by a majority in number (50%) being a majority whose debts or claims against the company amount in the aggregate to at least 75% of the total amount of the debts of the creditors present and voting.



Approval of the Court



The compromise is binding on the creditors of the Company and on the Company (the liquidator and contributories)

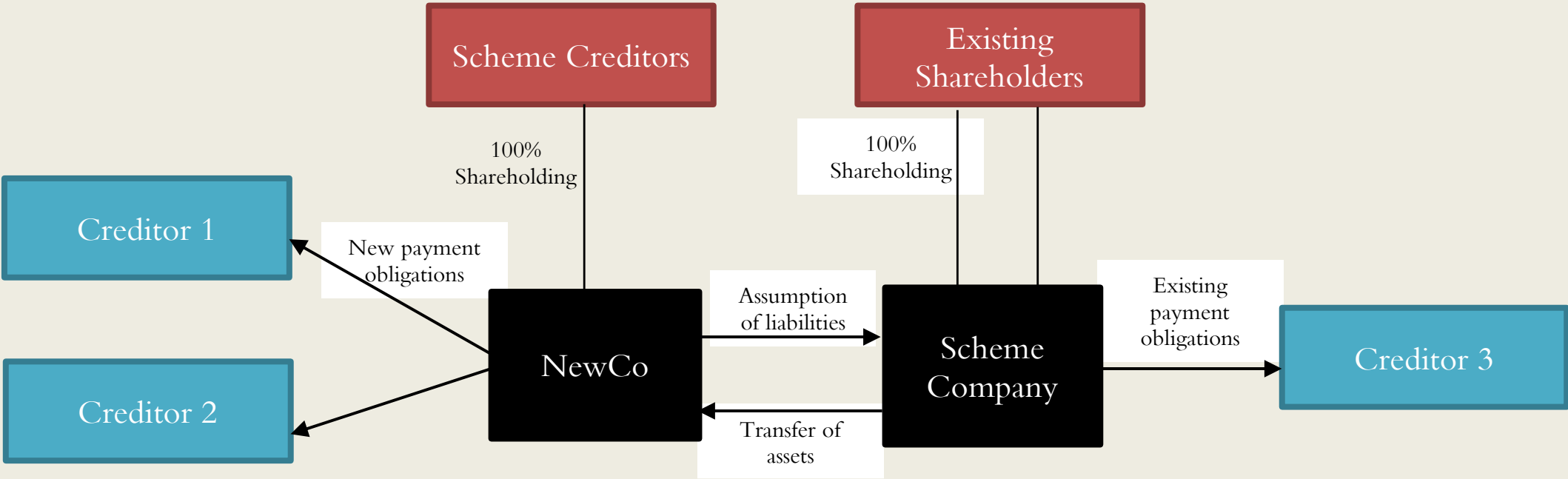
Common creditors' compromise schemes

A scheme of arrangement to restructure the debts of an insolvent entity typically involve creditors, in return for waiving some or all of their rights, receiving:

- a share in the future profits of the restructured business
- defined rights over the distribution of assets to creditors with varying rights or
- ownership rights over the restructured business (a debt for equity swap) – either by way of:
 - ownership rights over the company proposing the Scheme, or
 - ownership of a new company into which the Scheme company is transferring assets.

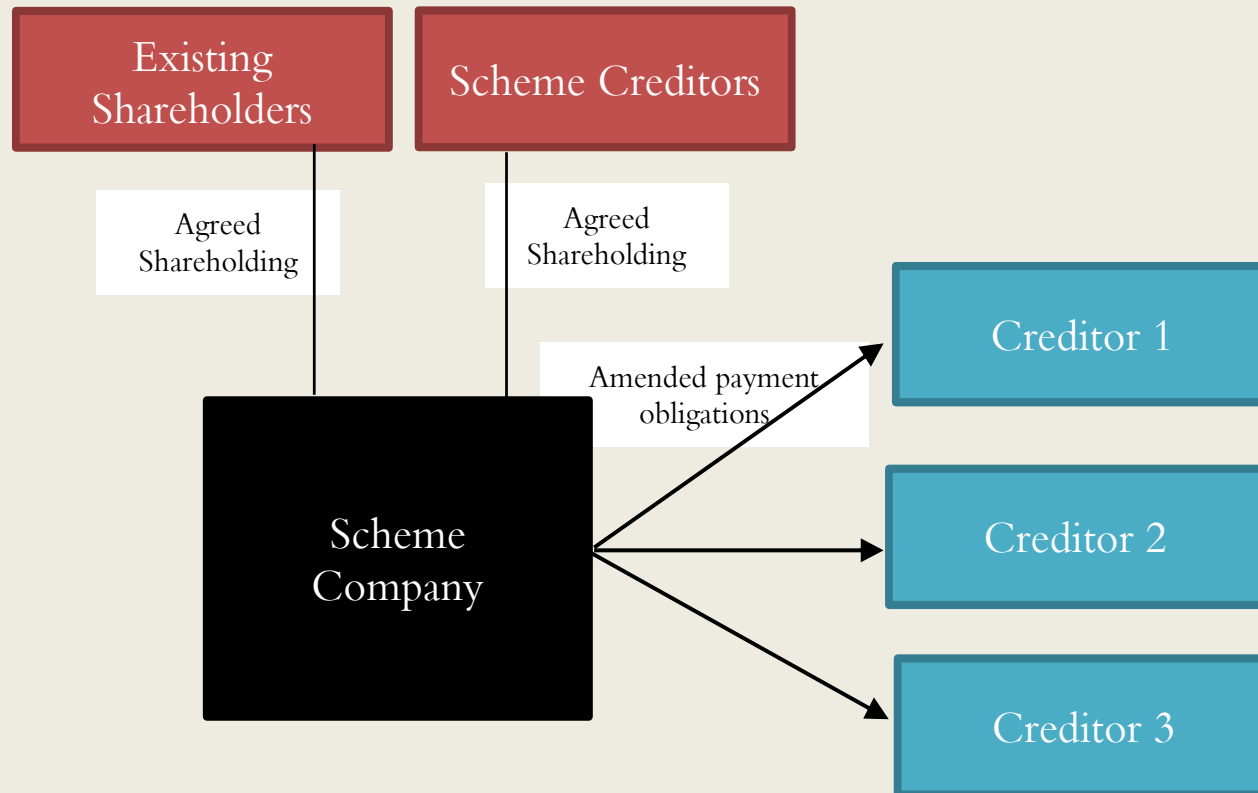
Common schemes (1)

Pre-pack scheme



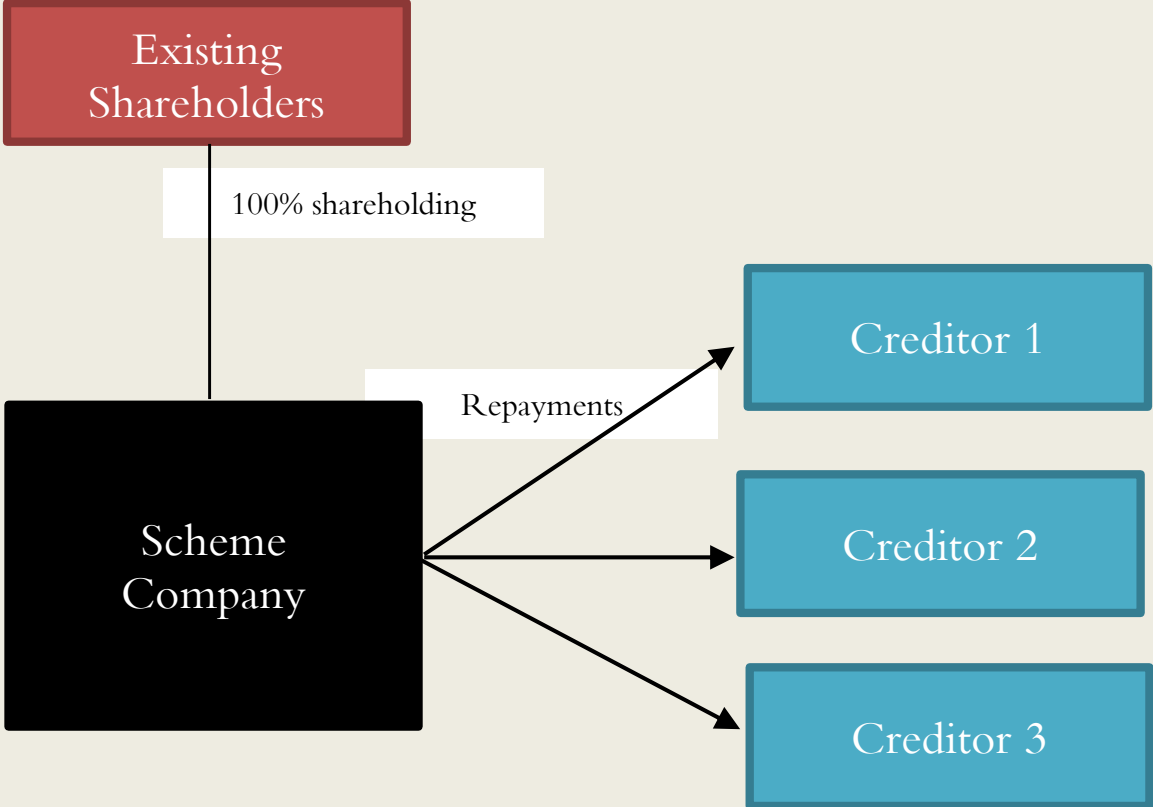
Common schemes (2)

Cram down scheme

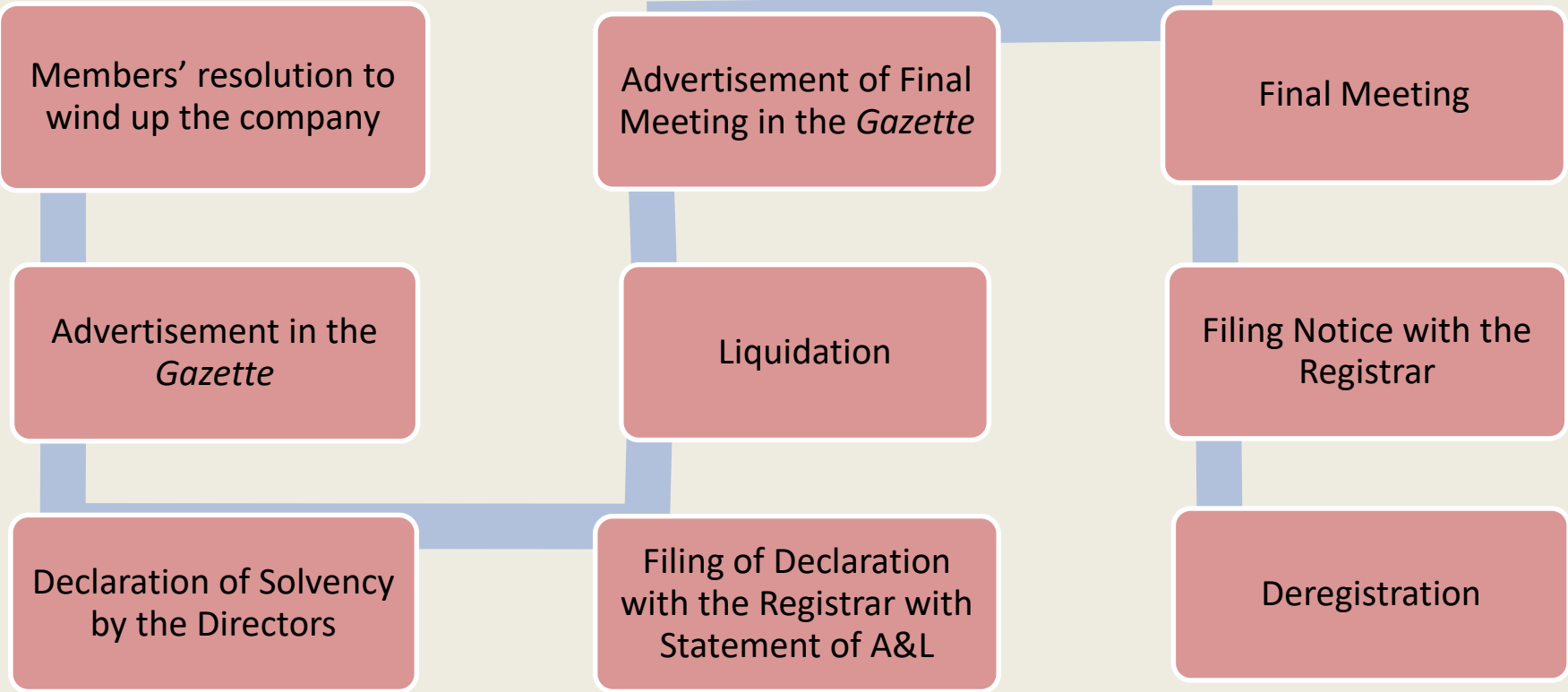


Common schemes (3)

Distribution scheme



Members' voluntary winding up



On the appointment of a liquidator, all the powers of the directors cease.

The company must, from the commencement of the winding up, cease to carry on its business (except so far as required for the beneficial winding up of the company).

Example

Virgin Atlantic Airways Limited (“VAAL”) Restructuring Plan:

The VAAL restructuring plan was sanctioned by the High Court on 2 September 2020. The UK-based airline experienced severe financial difficulty due to the impact of Covid-19 on the aviation industry. The Restructuring Plan addressed the claims of four categories of creditors:

- revolving credit facility (RCF) creditors: the RCF was to be converted into term loan with an extended maturity date and increased margin;
- aircraft lessors under English law governed leases: they were presented with three alternative options being to receive deferred rental payments, a rent reduction plus a bullet repayment or, thirdly, termination of the lease and redelivery of the aircraft;
- connected creditors: accrued debt was to be converted into preference shares in Virgin Atlantic Limited; and
- trade creditors: any outstanding debts after a certain date would be reduced by 20% and then paid out to the creditors in installments.

Advantages of a scheme

- Public notice not required (compromise proposal is lodged with the Companies Office)
- Lower reputational risk (generally viewed as a restructuring tool, not an insolvency process, less stigma than winding-up – so goodwill not impaired)
- Legal entities remain whole and directors remain in control.
- requires majority in number (50%) and 75% by value (by different classes of creditor) to vote in favour. Therefore also provides a tool for dealing with dissenting creditors.
- Once approved, the compromise is binding on all creditors
- Provides greater flexibility. A scheme can be more selective in its application. For example, it can be used to apply to a single class of creditors.

Disadvantages of a scheme

- If approved by the required majority of creditors, court approval is still required for the Scheme to go ahead (so additional costs and time)
- Requires a “no objection” advice from Registrar of Companies (possibly delays?)
- Schemes are typically more expensive for the company (compared to voluntary winding-up) but creditors may be prepared to contribute if their outcome is better.
- If creditors believe directors have been deficient in their duties, they may not support a scheme, and instead favour liquidation.
- Generally key creditors must work together – some creditors may see advantage in “striking first” through winding-up proceedings to get cash by way of a compromise (but which may lead to complicated preference litigation later).

Challenges (1)

- A court may reject a winding up application while it is considering a scheme – but there is no statutory/automatic moratorium protection available (a court would have to order it).
- Determining classes:
 - what are the rights which existing creditors have against the company and to what extent are they different?
 - to what extent are those rights differently affected by the scheme?
 - does the difference in rights or different treatment of rights make it impossible for the creditors in question to consider the scheme as one class?
- “No objection” from the Registrar of Companies [No local guidelines but ASIC guidelines may guide]

Challenges (2)

A court would generally approve a creditors' compromise where

- creditors have voted honestly and in good faith to support the scheme (no coercing)
- proposals contained in the scheme are fair and reasonable;
- all relevant matters have been brought to the Court's attention;
- proper and comprehensive disclosure of the details of the scheme has been made to the creditors of the company
- no evidence that any third parties will be adversely affected by the operation of the scheme
- scheme does not offend against any aspect of public policy;
- [Registrar of Companies] has provided a statement to the court that it does not object to the scheme.

It is not for the Court to second-guess the view of the statutory majority of the members in the exercise of their commercial judgment - *Re BRL Hardy Ltd* [2003] SASC 97 [20]

Conclusion

- in difficult times, important to consider all options, not just the easy one
- Fiji is a small country where people have long memories (!) – important for good relations (and for the economy) that companies in genuine trouble have a chance to work things out
- a “rush to winding up” may be self-defeating – expensive litigation leading to zero recovery or further litigation from a liquidator claiming unfair preferences
- a scheme may be a more co-operative approach to supporting a business with longer-term prospects and deliver better outcomes to creditors

Q & A

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