

Restructuring of russian and cis companies under english schemes of arrangement



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Abstract

This dissertation examines the nature and use of English schemes of arrangement as a restructuring tool for companies incorporated in emerging markets, namely in Russia and CIS region. Taking into account that the above-mentioned restructuring instrument can be used only under English Law, one of the main premises of this work will be connected with the exact mechanism of bringing the whole insolvency procedure to the jurisdiction of the UK. In other words, in what way can the schemes be applied outside UK and EU zone?

An attempt is being made to introduce a step-by-step guide of the whole procedure of approving restructuring plan by English court with arising issues and problems. In order to advance an argument of an increasing demand in such a restructuring tool for emerging markets, the dissertation looks at main benefits and advantages of the schemes, while also examining its criticism and negative aspects.

Further, the legal recognition of restructuring using English schemes of arrangement will be given consideration to, followed by an exploration of most notable cases such as the first reorganization involving schemes in Russia – Gallery Media restructuring procedure. A final part will focus on the future evolution of schemes in Russia and CIS region with a look on all the downsides and legislative proposals simplifying its use.

Introduction

The English law schemes of arrangement is an established tool for corporate restructuring and sometimes for M&A transactions in cases where a consensual solution between all the creditors of the company does not seem to be realistic. It is a statutory procedure regulated by the Companies Act 2006, which implies the compromise between the company itself and some or all of its creditors. The main benefit of schemes is the possibility to implement a restructuring solution at a lower approval threshold avoiding the need of unanimous or super-majority consent of a particular group of creditors. Thus, such a restructuring instrument gives the opportunity on a legal basis to cram down dissenting creditor minorities who would otherwise frustrate and disrupt a widely supported restructuring plan.

Schemes are rarely used solely and are often combined with other restructuring utilities such as pre-packaged administration for instance. The logic behind it is the possibility to facilitate the realisation of value from heavily leveraged financing structures.

As said before, the reason why English schemes of arrangement became so popular not only in the UK and in EU but also in developing countries is the ability of the majority to bind the minority. However, a notion should be made concerning the exact mechanism of so-called cramdown. English scheme allows only the minority creditors or shareholders within a class to have their rights varied without their consent. In other words, each class of creditors with a vote on the scheme must consent to it before the scheme will be sanctioned by the court.

The growing use of English schemes in the restructuring process for overseas-incorporated companies dates back to 2008 financial crisis and consequent economic downturn as in some cases it was more efficient and user friendly than local law alternatives. According to recent statistics, more than 75% of schemes are now used for the restructuring of the companies that originally were not headquartered in the UK.[1]

It should be particularly mentioned that scheme of arrangement is not exclusively an insolvency tool. Solvent companies can also use it for various purposes. For instance, the management sometimes refers to scheme for the purposes of takeovers in case there are dissenting minorities. Avoiding having entered formal insolvency procedure may have a number of advantages such as keeping control of the process internally, rather than giving control to an external insolvency practitioner or avoiding triggering default clauses in financial documents.[2]

The trend of referring to English schemes of arrangement by foreign companies has invoked an increased scrutiny by the courts in last years. Especially it affected the level of rigour to sanction the scheme requiring among other things additional evidence of the necessary sufficient connection to England.

Regardless the concerns of English courts, the popularity of schemes as a restructuring tool for foreign companies continues to grow. For Russian firms such an instrument very soon became extremely relevant as it opened an efficient way to reorganize the business in the context of hostile creditor minorities. This phenomenon is the consequence of economic sanctions

imposed by EU and the US on certain Russian individuals and companies after the political and military conflict in Ukraine. Russian companies, which are owned by, conduct business with or are connected to sanctioned individuals or entities may experience a decrease in or restrictions on leading the business and, as a result, face financial troubles. Moreover, even firms that are not connected to sanctioned individuals or entities but affected by sectoral sanctions in Russia may also be impacted as transnational consumers, investors or borrowers to take a more cautious approach in doing business in Russia or with Russian companies.[3]

According to all said above it does seem rational that Russian businesses were seduced by elegant simplicity of English scheme of arrangement: as long as a scheme receives the support of the statutory majority of creditors and is sanctioned by the English court, the scheme will be binding to all creditors, whether they voted for or against it. Moreover, in Russian legislation there is no adequate equivalent to schemes. The closest to it is article 451 of the Russian Civil Code that contains provisions of a party being able to ask the court to amend a contract, but only if there is a material change of circumstances.

All other restructuring options under Russian legislation would require consent of all creditors to proceed with the reorganisation, which makes the scheme much more favorable and highly sought by business. Taking into account the positive practice of sanctioning scheme of arrangement for foreign companies by English courts, it is not a surprise that schemes are evolving as desirable tool of choice for those engaged in complex cross-border restructuring procedures.

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The competence of English courts to sanction a scheme of arrangement for a foreign firm completely depends on whether the company has so-called sufficient connection with England. There are couple of ways to establish such connection, the most popular of which is the move of company's center of main interest (COMI) to England. This may include exercising all business's functions from its office in London, arranging for the daily management of the firm to be led by a London-based company, holding board meetings in London and keeping its cash in a London-based bank account.

However, unlike other restructuring procedures including administration, liquidation or company voluntary agreement a scheme does not necessarily require a firm to have its COMI in the UK in order to sanction the restructuring. Although having an English COMI used to be the way to establish a sufficient connection, there are now numerous court decisions proving that this is no longer a prerequisite: if English law is the governing law of the relevant debt documents, this alone is sufficient to create a link.

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Another important aspect of a scheme is that it is not a formal insolvency procedure. After all, the statutory provisions relating to schemes are found in the UK corporate legislation rather than the insolvency legislation and schemes are used in other circumstances not related to insolvency, including takeovers and solvent reorganizations.

[1]Christian Pilkington, *Schemes of arrangement in corporate restructuring*

(2nd edit. – Sweet & Maxwell, 2017)preface, p. xiii

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[2]Christian Pilkington, *Schemes of arrangement in corporate restructuring* (2nd edit. – Sweet & Maxwell, 2017), ch. 2 p. 9

[3]Amanda Jennings, Sonia Namutebi, “ *Restructuring Russian companies in England*” (September 2014, Morgan Lewis Ltd. – financierworldwide. com)

[4]Polina Lyadnova, Sui-Jim Ho “ *Untying the Gordian knot: Restructuring Russian and CIS Companies using English Law Schemes of Arrangement*” (Emerging Markets Restructuring Journal, Issue No. 1, Spring 2016. Pages 19-25)