Improving schemes of arrangement to better support businesses

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Abstract

The global pandemic has highlighted the need for further work to improve schemes of arrangements. This submission argues that it is time for the United Nations Commission on International Trade (UNCITRAL) or International Institute for the Unification of Private Law UNIDROIT, or both, to investigate the benefits of internationalising schemes of arrangements. While schemes of arrangements generally apply to domestic restructuring processes, adopting a transnational approach to internationalise schemes will strengthen alternative arrangements to the current UNCITRAL Model Law on Cross-Border Insolvency. This is not a criticism of national governments, nor UNCITRAL or UNIDRIOT, but rather, it calls for further research and to explore for schemes to have global effect. A pilot project could be established to undertake this work. There are many examples where such where conventions, model laws and principles established by these two organisations have been successful in protecting the economy and promoting a uniform approach to cross border trade and finance. These include, but not limited to, the Convention for the International Sale of Goods, Model Law on Cross-Border Insolvency and the Principles on Close Out Netting Provisions. While not all nation states have adopted these international legal tools, anecdotal evidence by the authors suggest that many national states do use them.

[1] This submission has been prepared and draws upon work recently undertaken by Dr Robert Walters (Victoria University) and Professor, Dr. Leon Trakman (University New South Wales), who argue for the internationalization of schemes of arrangement to assist Australian businesses engaged in cross border restructuring and insolvency. This work will be published in their forthcoming book titled: Cross Border Insolvency and Restructuring, which calls for further work to be undertaken by national governments, UNCITRAL and UNIDROIT to further internationalise cross border insolvency model law, close out netting provisions, and internationalise schemes of arrangement and comfort letters (used in restructuring, insolvency, liquidation). The importance of undertaking such reform has been highlighted by the impact from COVID-19, and the heightened tensions in the current day global economy. The book compares schemes of arrangement in Australia, China, European Union, India, Indonesia, United Kingdom and the United States.

1. Introduction

The recent pandemic is having a significant impact of the Australian and world business community. Increasingly, business are experiencing financial stress, the longer the pandemic rolls on, and lockdowns are imposed. In 2020, the World Economic Forum summarised the current deglobalisation activity insightfully as follows:

> 'With coronavirus (COVID-19) raising concerns around globalization and world trade, global value chains are beginning to fray, as countries look inwards for economic growth, write two experts. Since the early 1990s until recently, the world had been witnessing an economic 'convergence,' whereby poor countries were beginning to catch up with rich ones. Hyper-globalization drove the global export-to-GDP ratio from 15% to 25% over the two decades leading up to the 2008 global financial crisis. This export boom fuelled rapid growth in developing countries. There is every reason to worry that a historic process of deglobalization is underway, threatening to scuttle the growth models of poor countries that previously used trade as a path to prosperity. Worst of all, this disturbing shift has been met by silence or even encouragement by those who should know better. The intellectual response to deglobalization and the reversal of the historic process of convergence has been a near-deafening silence. Very few academics or policymakers in advanced economies have spoken up in defense of an open global order on behalf of poorer countries. Cosmopolitan elites who previously had been loud and enthusiastic champions of globalization have sat on their hands.'[2]

However, in the new digital economy, the globalisation of commercial and personal data increases annually. Data, while often not thought of as an issue in cross-border insolvency, has continued to emerge as being challenging and problematic, due to the fragmented approach of regulating cross-border data flows of personal data. In other words, by strengthening the global legal framework for transnational insolvency and restructuring, in our view, no one nation state should be disadvantaged, so long as the benefits in international economic growth are shared.

The evolving nature of the economic impact from COVID-19, reported by Laura Noonan in the Financial Times on 18 April, 2020, was that lenders were expanding reserves in anticipation of mounting waves of defaults during the pandemic alone.[3] These estimates included loan loss charges at

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[2] World Economic Forum, How Deglobalisation is hurting the world's emerging economies, https://www.weforum.org/agenda/2020/09/convergence-threatened-by-deglobalization-covid19/

[3] Laura Noonan, *US banks brace for surge in loan losses*, New York, Financial Times, https://www.ft.com/content/87189e79-a442-44b9-a699-7bce47b5bc64. This marks a 350 per cent surge in

six big US banks reached $25.4bn in the first quarter of 2020, a 350% surge from a year earlier.[4] Noonan reported that these large US banks had clarified that they were battening down the hatches to deal with an expected surge in loan losses as the pandemic cast serious doubts over the capacity of consumers and companies to pay their debts. Bank of America's finance chief, Paul Donofrio, explained how lenders set their credit provisions after 'weighting a number of different scenarios, all of which assumed a recession of various depth and longevity'.[5] The result of these scenarios was a 'marked drop' in Gross Domestic Production (GDP) in the second quarter of 2020, and negative growth in GDP extending well into 2021.[6]

Citigroup Chief Executive, Mike Corbat, indicated that Citibank had calculated its expected loan losses, using scenario-based modelled upon 'thousands of variables like GDP, unemployment, and many other stats' as well as 'the probability and severity of a recession'.[7] JPMorgan Chase assumed a 25 per cent fall in US economic growth in the second quarter of 2020, and unemployment above 10 per cent, 'followed by a solid recovery over the second half of the year'.[8] However, and while the pandemic has continued unabated throughout 2021, the full economic impacts may not be fully realised until 2023 to 2025. This prediction is based on the premise that the world and nation states have returned to pre COVID-19 economic activity and trade. If not, the financial stress of business could increase placing entities engaging in cross border trade and financial activities under greater financial stress. This, if realised, only heightens the call for work to centralise and internationalise schemes of arrangement to help facilitate reorganisations and restructures.

Therefore, on the backdrop of COVID-19, there is a need to investigate the need for significant international reform, and internationalise schemes of arrangement. Doing so, will provide a further level of legal certainty and shield, and will have significant benefits in providing the commercial sector with further confidence that internationalising such arrangements will provide both a robust and an alternative transnational approach to cross-border insolvency. Moreover, it will further underpin the importance these international organisations have in supporting and developing long standing harmonisation and legal convergence across the many legal families that currently exist across the world.

collective provisions across Bank of America, Citigroup, JPMorgan Chase, Wells Fargo, Goldman Sachs and Morgan Stanley versus a year earlier, as charges soared to levels not seen since the financial crisis.

[4] Ibid.

[5] Ibid.

[6] Ibid.

[7] Ibid.

[8] Ibid.

2. Schemes of Arrangement

An alternative to the sometimes costly and cumbersome process of insolvency, is to restructure the company. Any restructure could involve cross border arrangements whereby an entity has multiple branches spread out and located in various countries. Schemes of arrangement (SA), which have been a successful legal mechanism to assist in the restructure process. SAs arguably serve a 'useful economic function because they lessen the difficulty and costs for a company to rearrange its relationship with its shareholders or creditors for the purposes of facilitating, amongst other things, changes to capital structure'.[9] They have also been useful to corporate reorganisations such as 'mergers and takeovers, dispute settlement, and the restructuring of an organisation that is otherwise in the early stages of significant financial stress'.[10] This Chapter expands on the overall theme of the book by comparing the jurisdictions of Australia, China, European Union (EU), India, Indonesia, United Kingdom (UK) and the United States (US). It has been divided into two Parts. Part 1, examines Australia, EU, UK and US. Building upon Part 1, Part 2 compares Singapore, Indonesia, India and China.

This Chapter will demonstrate whether these jurisdictions have embraced schemes of arrangement, and how they have regulated for them. It will also identify a pathway forward, to ensure commercial entities have such an important legal tool available to them in the future, and how it can be improved. The Chapter will argue, comparably to its proposal for close out netting provisions, that either the UNIDROIT or UNCITRAL, or both, should undertake a formal review of SAs. The goal should be to develop an internationally agreed scheme of arrangement and embody it in uniform Principles and a Model law

It is our view that, in promoting a universal approach in cross-border insolvency, more needs to be done to assist in corporation restructuring and reorganisation. The rationale is that strengthening the legal tools to enhance the implementation of the universalist approach to restructuring and reorganisation will add another layer of legal stability and legal certainty to stabilize the international economy. The importance of restructuring entities cannot be underestimated. On their inception,

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[9] *Re Cheung Kong (Holdings) Ltd* [2015] 2 HKLRD 512. See also Mohan Goplan, *Creditors Schemes of Arrangement andDissenting Creditor Protection* (2018) 30 SAcLJ, 903-905. In Leon Trakman, Robert Walters, Cross Border Insolvency and Restructuring, forthcoming book.

[10] Charles Zhen Qu, Stefan H C Lo, *Schemes of Arrangement: Economic Analysis of three issues relating to Classification of Claims,* UNSW Law Journal Volume 40(4), (2017), 1440-1441. Schemes facilitate collective decision-making in that, absent this procedure, a proposed arrangement or compromise would not be binding unless there is unanimous consent, which can be costly to obtain. See also, *Re Aston Resources Ltd [2012] FCA 229; Re Kumarina Resources Ltd [2013] FCA 549; Re SABMiller Plc [2017] 2 WLR 837;* Jennifer Payne, Schemes of Arrangement: Theory, Structure and Operation (Cambridge University Press, 2014) chapters 3–4. In Leon Trakman, Robert Walters, Cross Border Insolvency and Restructuring, forthcoming book.

some scholars considered SAs as 'the ugly child of the corporate restructuring framework'.[11] SA's are now considered the restructuring vehicle or tool of choice for large companies and larger corporates to manage debt.[12] In some cases, SAs have provided states with the ability to transform themselves into financial hubs to which they attract business from across global and regional markets. The UK, typically, has served for some years as both a European and an international hub for the provision and regulation of financial services. These services include a globally recognized framework to facilitate clear and efficient restructuring procedures.

SAs can serve as valuable and flexible tools in reorganising a company's capital.[13] Therefore, the Chapter will trace the steps in the development of SAs. It will examine the applicability or otherwise of SAs in cross-border restructuring-reorganisation activities. Trakman and Walters note that central to the overall advantages of SAs is the idea that it can be used by companies, creditors and members to agree a very wide range of reorganisations or alterations in relation to the company's capital, provided that the agreement is subsequently sanctioned by the court.[14] They offer a way forward to assist companies to reorganise their debt and/or equity capital effectively. A further benefit is their flexibility.[15] They can be used either as an alternative to, or alongside, more traditional legal and practical mechanisms for reorganising a company's capital A completed SA also provides the parties with a level of certainty and finality. This is reflected in an agreement that the parties negotiate and if sanctioned by a court, is binding upon them. In practice, SAs are court-sanctioned compromises between a debtor company and one or more classes of creditors.[16] Once the negotiated agreement or 'scheme' has been approved by members and creditors and sanctioned by a court, it will be set aside subsequently in very limited circumstances. In general, this will only occur where 'consent of the members and/or creditors has been obtained by fraud, although in some cases the court will refuse to set aside the scheme even where fraud has occurred'.[17] Such 'schemes of arrangement' provide further certainty in enabling the majority of the members or creditors to reach a scheme by agreement that also binds minorities. Arguably, that result limits the risk of schemes of arrangement failing due

[11] Gerald McCormack, Jennifer Payne (2014) *Schemes of Arrangement, Theory, Structure and Operation,* Cambridge University Press, Cambridge, x1vii and 409 pp., ISBN: 9781107016408., *Eur Bus Org Law Rev* 16**,** (2015), 167-171.
[12] Ibid.
[13] Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation*, Cambridge University Press (2014), 1-2.
[14] Leon Trakman, Robert Walters, Cross Border Insolvency and Restructuring, forthcoming book.
[15] Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation*, Cambridge University Press (2014), 3.
[16] Adam Gallagher, *The Growth of Schemes of Arrangement as the Tool of Choice in Complex Restructurings*, AM. BANKR. INST. J., Oct. (2010) 36.
[17] Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation*, Cambridge University Press (2014), 3. See also Crhitian Pilkington, Kevin Heverin, *Schemes of Arrangement in Cross-border Restructuring-Issue of Jurisdiction and Recognition*, Whit&Case, ChaseCambria, Vol 8, (2001), 1. In Leon Trakman, Robert Walters, Cross Border Insolvency and Restructuring, forthcoming book.

to dissension or recalcitrance among a minority of the parties, unless the court requires their agreement at some level. Throughout this chapter schemes of arrangement will be referred to in full or by reference to schemes or SA.

However, there are disadvantage for the use of SAs. They have been viewed as 'complex, cumbersome and expensive'.[18] Trakman and Walters argue that by and large, this has been a result of significant court supervision required in some cases. On the other hand, this is likely to differ depending on the jurisdiction. Furthermore, they often used to separate groups of members and creditors into classes to consider and vote on the scheme-itself. This requirement creates logistical and classificatory difficulties, and is undoubtedly one of the most complex issues for a company wishing to make use of this legal mechanism.[19]

A further accentuating issue, to confirm or otherwise, is the consistency of the regulation and application of schemes of arrangement in the jurisdictions examined and compared throughout this book. An additional issue that has also arisen is whether there is enough legal convergence amongst states to retain these arrangements under the responsibility of national law, or to internationalise them. In making the case for schemes of arrangement to be not only nationalised, there is a further call to internationalise these tools.

In a recent study and comparing Australia, China, European Union (EU), India, Indonesia, United Kingdom (UK) and the United States (US), Trakman and Walters noted that SAs are regularly adopted and widely used in practice. Supporting the case for globalising SAs through an international convention, is the destabilization of global economies arising from Covid-19, and the accompanying financial stress faced by business entities engaged in cross-border transactions. In addressing these issues, the UNIDROIT Principles on Close-out Netting Provisions, in our view demonstrates that the unification of netting laws globally, has in part, and while not adopted by all states, does assist in advancing international financial stability.[20] The authors further note that to accentuate economic stabilisation globally is the Convention on the International Sale of Goods (CISG), even though it has not been adopted by all states. Arguably, the internationalisation of schemes of arrangements can assist further in stabilizing trans-border economic activity.

A preliminary issue is to determine the current manner and scope of SAs in international law and practice. Firstly, Walters and Trakman argue that a question arises as to the level of impact the

[18] Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation*, Cambridge University Press (2014), 5.
[19] Ibid, 6.
[20] Leon Trakman, Robert Walters, Cross Border Insolvency and Restructuring, forthcoming book.

UNCITRAL Model Law on Cross-Border Insolvency has had on SAs. While not specifically stated in the 1997 UNCITRAL Cross-Border Insolvency Model Law, SAs are mentioned in the later 2004 UNCITRAL Legislative Guide to Insolvency. It states 'that not all debtors that falter or experience serious financial difficulty in a competitive marketplace should necessarily be liquidated; a debtor with a reasonable prospect of survival (such as one that has a potentially profitable business) should be given that opportunity where it can be demonstrated that there is greater value (and, by deduction, greater benefit for creditors in the long term) in keeping the essential business and other component parts of the debtor together'.[21] It goes onto say that 'reorganization, however, does not imply that all of the stakeholders must be wholly protected or that they should be restored to the financial or commercial position that would have obtained had the event of insolvency not occurred'.[22] In referring to reorganisation, the UNCITRAL, arguably, has the same meaning as restructuring and entity. As a result, the use of a scheme to reorganise an entity, as conceived under the UNCITRAL, achieves the same result as under a restructure.[23]

More specifically, Trakman and Walters make the point that the reorganization or restructure of an organisation does not imply that the debtor will be completely restored, or that its creditors will be paid in full, or that ownership and management of an insolvent debtor will continue to preserve their pre-existing positions. Management of the debtor entity may be changed, and therefore, the interests of equity holders may be reduced, employees may be retrenched and the source of a market for suppliers may disappear. In general, however, the restructure does imply that whatever form of plan, (scheme or arrangement) is agreed, the creditors will eventually receive more than if the debtor were to be liquidated.[24] It is our view that there could be a rise in the use of SAs, as the economic conditions resulting from the global pandemic in 2019-2021 and beyond, continue to reshape and impact the economy placing ever more businesses into financial stress. To manage whatever level of financial stress a business is enduring, one option is the use of a restructuring program, via a scheme of arrangement.

By expanding on the already preventative approach to insolvency at the national level and raising it to the international sphere, the benefits of having transnational schemes of arrangement, will arguably, outweigh their limitations.[25] Adopting a preventive approach to schemes of arrangement that is comparable to the approach to cross-border insolvency, in our view, in enabling the debtor to retain

[21] The United Nations Commission on International Trade Law (UNCITRAL), Legislative Guide on Insolvency Law, 2005, 27-29. Note this Guide came after the UNCITRAL 1997 Model Law on Cross-border Insolvency was implemented.
[22] Ibid, 27-29.
[23] Ibid.
[24] Ibid.
[25] Leon Trakman, Robert Walters, Cross Border Insolvency and Restructuring, forthcoming book.

possession of the company during the life of the scheme of arrangement. The resulting benefit is in allowing a financially stressed company to retain its management and knowledge base, while restructuring to obtain an improved financial position. Internationalising that approach also provides greater certainty to debtors and creditors that operate businesses in multiple jurisdictions. It reinforces the already universalist approach to cross border insolvency, and it an important extension to insolvency.

Notwithstanding the above, the study undertaken by Trakman and Walters highlighted how in 2020 the UK undertook a law reform process whereby they introduced a compromise plan in the UK. This important step following their exit from the EU, bought them in line with the US, in favouring a compromise plan, while adopting a preventative approach to insolvency, outside of a scheme.[26] This process is considered more rigid because it cannot be used to disrupt a proposal that can save a company. Still, this compromise plan does demonstrate a movement towards transnational uniformity, through its adaption in two states that serve as hubs for international finance transactions. It also reinforces the process by which leading trade and investor states continue to look to each other to internationalise systems and processes through their national laws.[27] More importantly, these progressive steps required in adopting and enforcing n a compromise plan extends further protects debtor companies and their creditors by providing an option to precede, and potentially displace, the debtor declaring insolvency. It also adds further to the stability of the economy, particularly in times of global economic and financial stress, including but not limited to the Pandemic. However, further research is needed to determine the manner in, and extent to which, other states have adopted similar steps in using compromise plan, even though they refer to them differently.

However, we do not envisage perfect harmony in the law and practice relating to schemes of arrangement. States that compete for international business and seek to preserve their sovereignty as independent nations, are unlikely to fully forego their control over such arrangements. What is envisaged is the emergence of greater uniformity in the nature and application such schemes, in acquiring comparable functional properties and being capable of application in cross-border trade and investment.[28] Different nomenclature in describing such schemes is not critical in practice. As noted by the Trakman and Walters comparative study, some states refer to such schemes as schemes of arrangements, while others refer to them as restructuring plans. These differences need to be taken into consideration, but without disregarding their similar purposes and application.[29] Their adoption as legal mechanisms also need to reinforce their function as important alternative legal tools that

[26] Leon Trakman, Robert Walters, Cross Border Insolvency and Restructuring, forthcoming book.
[27] Ibid.
[28] Ibid.
[29] Ibid.

assist in sustaining companies that are in financial stress. On the other hand, these differences should not undermine the growth of an international regime in which such plans and schemes are capable of being reconciled.

3. Conclusion

In making the case for the need to internationalise schemes of arrangement to and for the benefit of Australian entities cannot be underestimated. Prevention is always better than the cure, when there is a local, national or international disease outbreak. Therefore, adopting a similar preventative approach at the international level, can not only have significant economic benefits to Australian companies, it also, places Australia at the forefront of current and future international policy and legal reform. There is no better time for Australia to engage other countries and the international community to either develop a pilot project or undertake a comprehensive review-research into the international harmonisation of schemes of arrangements.

As highlighted by Trakman and Walters, the transition from a territorial approach to cross-border insolvency, or from insolvency in general to a universalist approach, is enabling indebted entities to restructure or reorganise. The authors make the point that their small comparative study demonstrated that they are already nationally regulated for, and provide an important mechanism for restructuring and insolvency.

Therefore, schemes provide a high level of certainty and governance in a restructure. The flexibility SAs provide an approach to structuring complex transactions within a takeover or restructure. Furthermore, SAs are often viewed positively by courts and offered to shareholders. Having a level of court oversight, adds a further level of certainty that the obligations outlined within such a schemes will be implemented. Their flexibility also extends beyond the sometimes prescriptive and technical regulatory requirements that need to be met under takeover arrangements. Moreover, a scheme of arrangement helps to facilitate the transfer of assets and liabilities, and the issuance of new shares where appropriate.

Viewed in this way, SAs are important alternative tools to insolvency in enabling an entity under financial stress to maintain its business operations.[30] Promoting the wider and more uniform use of SAs nationally, in our view, will also foster its more extensive and productive use during and post COVD-19. We maintain that the evidence supported the growing adoption of SAs nationally and

[30] Leon Trakman, Robert Walters, Cross Border Insolvency and Restructuring, forthcoming book.

their wider application to cross-border insolvency and restructuring proceedings before domestic courts and international commercial arbitration proceedings.[31] Moreover, the similarities between how domestic courts engage in SAs outweigh their differences.[32] A multilayered and multipurpose regulatory regime of SAs is also more likely to gain ground to reduce in transborder proceedings, given heightened international uncertainty and tension arising from global public health and financial crises.[33]

In conclusion, we strongly argue that the world in facing increased uncertainty, incoherence and contestability, therefore such crises render it timely for the UNIDROIT or UNCITRAL undertake a formal review of SAs, for the purpose of developing uniform principles based on an internationally agreed scheme of arrangement, or conceivably, a model law, or a set or agree principles.[34] It is argued that by aggregating these types of legal mechanisms to the international level will strengthen market stability and certainty in response to a relentless pandemic and the prospect of further ones arising. Not doing anything, only weakens and dilutes the overall regulatory framework for cross-border insolvency, and to also cross-border restructuring.

[31] Leon Trakman, Robert Walters, Cross Border Insolvency and Restructuring, forthcoming book.
[32] Ibid.
[33] Ibid.
[34] Ibid.