LexisNexis®

Lexis®PSL R&I Practice Note

Akin Gump
STRAUSS HAUER & FELD LLP

Transfer schemes under section 900 of the Companies Act 2006 (or schemes of reconstruction and amalgamation)

A Lexis PSL Restructuring & Insolvency document produced in partnership with Emma Simmonds, Lois Deasey and Timea Bagossy of Akin Gump LLP

Executive summary

- a scheme of reconstruction or amalgamation, also known as a transfer scheme (transfer scheme) is a type of scheme of arrangement under the Companies Act 2006 (CA 2006), section 900
- transfer schemes are not common in practice. The few reported cases of successful transfer schemes relate to solvent corporate re-organisations
- the procedural rules and steps for a transfer scheme are broadly the same as those required for a scheme of arrangement under CA 2006, s 895 (section 895 scheme). However, the powers available to the court under CA 2006, s 900 when hearing an application to sanction a transfer scheme are wider than those available to it when sanctioning a section 895 scheme
- the transferor company and the transferee company in a transfer scheme must have substantially the same shareholders, which means that transfer schemes cannot be used to effect takeover offers or debt for equity swaps
- unlike section 895 schemes, transfer schemes are not available in respect of companies incorporated outside of England and Wales, reducing the contexts in which they can be employed
- A transfer scheme cannot transfer rights which as a matter of general law are not transferable, including personal service contracts and other non-assignable contracts. An exception to this is employment contracts which can be transferred between the transferor and transferee companies under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (SI 2006/246) (TUPE)

What is a transfer scheme?

A transfer scheme is a type of scheme of arrangement under CA 2006, s 900 which can be used to facilitate schemes involving the reconstruction of one or more companies, or the amalgamation of two or more companies. The terms reconstruction and amalgamation do not have precise legal meanings, but they are considered in more detail below.

Transfer schemes are distinct from section 895 schemes which are proposed more commonly and particularly in the context of takeover offers and debt restructurings. The key similarities and differences between both types of scheme are considered below. It should also be noted that a separate regime under Part VII of the Financial Services and Markets Act 2000 (FSMA 2000) applies to business transfers relating to insurance or banking companies but that regime is not considered in this note.

Similarities and differences between a section 895 scheme and a transfer scheme

As with a section 895 scheme, it is not necessary for a company proposing a transfer scheme to be in insolvency or in financial distress. The procedural rules and steps for a transfer scheme are broadly the same as those required for a section 895 scheme. Those requirements include:

- an application to court to convene one or more class meetings of shareholders or creditors, as applicable, whose rights are to be affected by the scheme
- a vote by each class of shareholders or creditors on the scheme proposals, which must be approved by a majority in number and at least 75% in value of the creditors or shareholders in each class present and voting at the scheme meeting (in person or by proxy)

- assuming the voting thresholds are met, a subsequent court application to request the court to exercise its discretion to sanction the scheme
- on becoming effective, the scheme binding the company and all of its shareholders or creditors, as applicable, regardless of whether each shareholder or creditor voted in favour of the scheme

However, there are some important distinctions between transfer schemes and section 895 schemes. First, under CA 2006, s 900 it must be shown that:

- *the compromise or arrangement is proposed for the purposes of, or in connection with, a scheme for the reconstruction of any company or companies, or the amalgamation of any two or more companies, and*
- *under the scheme the whole or any part of the undertaking or the property of any company concerned in the scheme (a transferor company) is to be transferred to another company (the transferee company).*

Transfer schemes may only, therefore, be used in relation to an amalgamation or reconstruction where the business or property of the scheme company is being transferred to another company. The transferor company and the transferee company in a transfer scheme must, following the amalgamation or reconstruction, have substantially the same shareholders as one another. In this respect, the scope of CA 2006, s 900 is narrower than CA 2006, s 895, which can be used for a variety of arrangements between a company and its creditors or shareholders which do not necessarily involve the transfer of the business or property of the company concerned or require commonality of shareholders. The narrower scope of the transfer scheme regime means that it is a less flexible tool than the section 895 scheme regime, and consequently is utilised less often. In particular, the requirement for commonality of shareholders also means that it cannot be used to implement restructurings involving an exchange of debt for equity, or in the context of takeover offers. The meanings of the terms reconstruction and amalgamation and the requirements for commonality of shareholders is considered in further detail below.

Secondly, by virtue of CA 2006, s 895(2)(a), transfer schemes may only be proposed in respect of a company as defined in CA 2006, s 1 (ie, a company which is formed and registered under CA 2006). This contrasts with section 895 schemes, which may be proposed in respect of any company which is liable to be wound up in England and Wales provided that it can be demonstrated that there is a sufficient connection between the company and the jurisdiction. Provided it can demonstrate this, a foreign company is able to avail itself of CA 2006, s 895 to achieve a compromise or arrangement with its creditors or shareholders that may not be possible under the law under which it was incorporated. Indeed, many high-profile cases on schemes in recent years, particularly in the financial restructuring context, have concerned foreign companies and the English courts have been prepared to find that a sufficient connection exists on increasingly varied grounds. The fact that transfer schemes are only available to companies incorporated under CA 2006, thereby excluding foreign companies, accounts in part for their relative rarity compared to section 895 schemes.

A third difference between transfer schemes and section 895 schemes is the powers available to the court under CA 2006, s 900 when hearing an application to sanction a transfer scheme. CA 2006, s 900 confers jurisdiction on the court to make a wide range of orders to facilitate a scheme when sanctioning it, whereas the courts can only issue a sanction order at the sanction hearing of a section 895 scheme. For example, under CA 2006, s 900(2), the court may make an order in relation to:

- the transfer of property or liabilities from one company to another
- the taking over of legal proceedings by or against the transferee company by the transferor company
- the dissolution, without winding up, of the transferor company
- any supplemental matters necessary to ensure that the reconstruction or amalgamation is fully and effectively carried out

Meaning of reconstruction and amalgamation

The terms reconstruction and amalgamation are not defined in CA 2006. However, judicial consideration of these terms as they appear in other statutory contexts provides guidance as to how the courts are likely to construe the terms in an application under CA 2006, s 900.

In *Re South African Supply Co [1904] 2 Ch 268* the court considered the interpretation of reconstruction and amalgamation as they were used in a company's articles of association. The court noted that neither reconstruction nor amalgamation had a definite legal meaning, that each of these terms is a commercial rather than a legal term and even as commercial terms they have no exact meaning.

Reconstruction

According to *Re South African Supply*, a reconstruction involves an undertaking of a company being in substance preserved and transferred, not to a third party, but to another company (the transferee company), consisting substantially of the same shareholders as the transferee company, with a view to the undertaking being continued by the transferee company. The court held that it is not necessary that all assets and liabilities pass to the transferee company, or that all shareholders of the transferor are shareholders in the transferee company.

In *Brooklands Selangor Holdings Ltd v IRC [1970] 2 All ER 76* the term reconstruction was considered in the context of the Finance Act 1927 (FA 1927) to determine whether stamp duty was payable as a result of the relevant transactions. The court held that there was no reconstruction after the transfer of part of a company's undertaking to a transferee company, when the shareholders in the transferee company comprised a majority in number, but less than half in value of the shareholders in the transferor company. On similar facts in *Swithland Investments Ltd and another v Inland Revenue Commissioners [1990]*

STC 448 no reconstruction was found because, following the transfer, the shareholders of the four transferee companies concerned were not substantially the same as the shareholders of the transferor company, and because the transaction was merely a partitioning of the transferor's assets between the four companies.

In *Baytrust Holdings Ltd v IRC [1971] 3 All ER 76* only certain assets which were not required by the transferor in its core business were transferred to its shareholders in the form of shares in a new company. After the transfer, the transferor continued with the same objects, business, capital and shareholders. In those circumstances, the court held that there was no reconstruction for the purposes of FA 1927.

In *Re MyTravel Group plc [2004] EWHC 2741 (Ch), [2004] All ER (D) 385 (Nov)* a company proposed a scheme of arrangement to effect a debt for equity swap with its major creditors through a transfer of the company's assets and liabilities to a newco under section 425 of the Companies Act 1985 (CA 1985) (the precursor to CA 2006, s 900). The court held that it could not grant leave for the company to convene the creditor meetings for a scheme as the scheme under CA 1985, s 425 was not a transfer scheme capable of being sanctioned by the court. This was because only 4% of the value of the shareholding in the transferee company was to be held by 100% of the shareholders in the transferor company. On that basis, the court concluded that there was no substantial common identity between the two bodies of shareholders. It was argued before the court that the reference in *Brooklands Selangor* to persons interested in the company was not limited to shareholders but would include or be replaced by creditors in the case of company which was in the zone of or in insolvency, and therefore if the creditors of the transferee and transferor companies were substantially the same following the debt for equity swap, CA 1985, s 425 should be available. However, Mann J did not accept this argument, noting that the authorities specifically contemplated shareholders rather than creditors, and that if substantial common identity of shareholders is not present, what might be said to be reconstructed is not so much the company as its debts.

There is no clear test that emerges from these cases as to what constitutes a substantial common identity between the shareholders of the transferor and the transferee company. However, the authorities demonstrate that both the number of shareholders and the value of their holdings in the transferor and transferee company are relevant and it is likely that it would require more than a simple majority of the original shareholders in number and in value to constitute substantially common identity.

Amalgamation

In *Re South African Supply [1904] 2 Ch 268* the court held that an amalgamation involves the rolling of two concerns into one (ie, the blending of substantially two or more existing undertakings into one undertaking) with the shareholders of each company becoming the shareholders in the company which holds the blended undertakings. Buckley J noted that an amalgamation could be achieved (i) by the transfer of two or more undertakings' businesses and assets to a new company, or (ii) the transfer of one or more undertakings' business and assets to an existing company.

In *Swithland Investments Investments Ltd and another v Inland Revenue Commissioners [1990] STC 448* (para 464), the court applied Buckley J's definition to a series of share transfers and exchanges to effect a corporate reorganisation to determine whether an amalgamation had occurred such that stamp duty would not be payable under FA 1927. The court held that the mere purchase of shares in one company by another did not bring about an amalgamation of the company and that there had been no coming together of two entities, nor any welding or blending of two undertakings into one.

Similarly, in *Re Walker's Settlement, Royal Exchange Assurance Corpn v Walker and others [1935] Ch 567 [1935] All ER Rep 790*, in which a newly formed holding company acquired 90% of the capital of six existing electricity supply companies under a scheme of acquisition, the scheme was not held to be an amalgamation within the meaning of section 10(3)(c) of the Trustee Act 1925 because each of the six companies continued to exist and therefore there was no blending together of the companies.

Transfer schemes and debt for equity swaps

Following the decision in *Re MyTravel [2004] EWHC 2741 (Ch), [2004] All ER (D) 385 (Nov)*, the prevailing view is that a substantive debt for equity conversion is not possible using CA 2006, s 900. This is because such a conversion would result in a dilution of the interests of the original shareholders to a nominal level with the transferor company's creditors becoming the shareholders of the transferee company. That outcome is in direct conflict with the requirement for a substantial common identity between the shareholders of the transferor and transferee in a transfer scheme.

Re TSB Nuclear energy: a successful transfer scheme

A recent and rare example of a successful amalgamation through a transfer scheme can be found in *Re TSB Nuclear Energy Investment UK Ltd [2014] EWHC 1272 (Ch)*. The case involved a subsidiary, H, and its parent company, X, which were controlled by X's parent, T. The scheme was proposed as part of a solvent group reorganisation to streamline the group and allow T to control H directly. Through the scheme, H would acquire all the assets and liabilities of X, after which X would be dissolved by an order of the court under CA 2006, s 900(2)(d). T would subsequently receive shares in H. Under this structure, no stamp duty would be payable in the UK and no capital gains tax would arise in Japan, where T was incorporated.

The High Court approved the scheme. In reaching its decision, the court considered a number of points which will be useful in practice when considering the application of transfer schemes. First, the court considered whether the interests of creditors of the companies involved in the amalgamation would be prejudiced. The judge concluded that the creditors of X would not be prejudiced as they would have a claim against H, which had a strong balance sheet, nor would the creditors of H be prejudiced because X had substantial assets, which would be available to H following the scheme.

The court also considered whether the scheme gave rise to a distribution by X of the value of all of its assets to its parent, T, thereby offending the principle of maintenance of capital (ie, the principle that the capital of a company has to be maintained when it has been paid up, and reserves may only be distributed if they derive from an increase in the value of the company through trading or other activities). It was held that the scheme did not offend this principle because CA 2006, s 900 trumped any general restrictions elsewhere in CA 2006, and that the protection of creditors against the distribution of the company's assets through CA 2006, s 900 was two-fold:

- any transfer under CA 2006, s 900 is subject to court approval, and
- the court could make provision under CA 2006, s 900(2)(e) for dissenting creditors who claimed they were prejudiced by the scheme

Finally, the judgment highlights the inability of a transfer scheme to transfer rights which as a matter of general law are not transferable, including personal service contracts and other non-assignable contracts. This principle was established in *Nokes v Doncaster Amalgamated Colleries Ltd [1940] AC 1014* which concerned the precursor to CA 2006, s 900. While employment contracts can be transferred between the transferor and transferee companies under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (SI 2006/246) (TUPE), a residual category of non-assignable contracts cannot be transferred under CA 2006, s 900 (unlike the equivalent regime for transfers under FSMA 2000, Part VII, under which such contracts can be transferred at the court's discretion). On the particular facts, there were no such contracts that gave rise to this issue for the court, although the judge did note that the issue was one of the main reasons that very few companies made use of the transfer scheme regime.

Conclusion

There are few reported cases under CA 2006, s 900 and fewer instances of the court finding that a transaction constitutes a reconstruction or amalgamation. The decision in Re TSB Nuclear Energy demonstrates that transfer schemes are likely to be most useful in tax neutral corporate reorganisations rather than takeovers or complex financial restructurings. This is principally because transfer schemes:

- may only be proposed in respect of companies incorporated under CA 2006
- cannot be used to transfer non-assignable contracts, and
- since the decision in *Re My Travel*, are not deemed suitable to effect debt for equity swaps in which the shareholder profile of the transferee company differs substantially to the shareholder profile of the transferor entity

Emma Simmonds

Profession: Partner

Biography

Emma Simmonds' practice focuses on advising creditors on complex cross-border restructurings, financings and refinancings. She acts for a broad range of financial institutions including private placement noteholders, insurance companies, pension funds, hedge funds, banks, creditor committees, and bondholders. Emma also has experience of advising on general distressed lending matters and debt and claims trading.

Her representative transactions include:

- Advising private placement noteholders on waivers and amendments in connection with covenant defaults by Royal Imtech
- Advising private placement noteholders on the financial restructuring of Wagon plc, Deutz A.G. and Hampson Industries plc
- Advising senior lenders in LBO restructurings, including the Terreal Group and Monier
- Representing mezzanine lenders in LBO restructurings, including Gala Coral, Viridian, Alliance Medical, Europackaging and 20:20
- Advising sole senior lender on the €480 million refinancing of a real estate portfolio with properties in Germany, Belgium and the Netherlands
- Advising noteholders on the restructuring of high yield bonds issued by Invitel, Independent News & Media Plc, Damovo Group, Emap, Torex Retail and Luxfer Holdings
- Advising Norsk Tillitsmann ASA, on behalf of holders of Norwegian law bonds issued by Skeie Drilling AS, Master Marine ASA and Remedial (Cyprus) Public Company Limited
- Advising investors in relation to sovereign bonds
- Author of Transfer schemes under section 900 of the Companies Act 2006

Timea Bagossy

Profession: Associate

Biography

Timea Bagossy practices in the Financial Restructuring group and has been working on domestic and cross-border restructurings, insolvencies and workouts, representing hedge funds, bondholders, institutional lenders and creditor committees.

She is an English qualified lawyer who completed a three month secondment at Lehman Brothers International (Europe) during its administration.

Her representative transactions include:

- Advising the bondholder committees on the restructuring and wind-down activities of the collapsed Icelandic banks Glitnir and Landsbanki
- Representing ad hoc committees of bondholders of Equinox, Rubicon Offshore and Sea Production
- Advising senior lenders on the restructuring of the Terreal Group, a worldwide manufacturer of terracotta products based in France
- Advising the administrators of Comet Group Limited
- Author of Transfer schemes under section 900 of the Compnies Act 2006

Lois Deasey

Profession: Associate

Biography

Lois Deasey advises hedge funds, bondholders, bank and institutional lenders on UK and cross-border financial restructurings, workouts and insolvencies.

Her representative transactions include:

- Advising private placement noteholders on waivers and amendments in connection with covenant defaults by Royal Imtech
- Advising senior secured bondholders of Invitel, a Hungarian telecoms operator, on a restructuring implemented through a scheme of arrangement under English law
- Advising the coordinating committee of senior lenders on the restructuring of the Terreal Group
- Author of Transfer schemes under section 900 of the Compnies Act 2006