A Democratic Solution: Managing the Headcount Test in Schemes of Arrangement Offshore*

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The Scheme of Arrangement (“Scheme”) was introduced into British Virgin Islands law in 2006 and has extended the range of options available to companies under the BVI Business Companies Act 2004, already known for its flexibility. Perhaps because of the stage of the economic cycle at which it was introduced, the principal use of the Scheme in the BVI to date has been in the context of corporate insolvencies, and the Scheme has been welcomed as a creative and efficient mechanism for effecting a compromise between a company and its creditors.

The Scheme has its origins in 19th century English legislation as a means for a company in liquidation to compromise with its creditors and was extended in 1908 to include companies other than those in liquidation and compromises with members as well as creditors. From its English origins, the Scheme has become a feature of corporate legislation worldwide: alongside the BVI, the laws of Hong Kong, Singapore, Malaysia, Australia, India, Bermuda, Ireland, Guernsey, Jersey, and the Cayman Islands, amongst others, now all make provision for Scheme-based compromises derived from the English prototype, and to similar effect.

The Scheme provides a tried and tested mechanism which permits a company, with the consent of the relevant class or classes of members or creditors and the sanction of the Court, to enter into a binding compromise or arrangement with its members or creditors, or any class of them, respectively. There is no need for them to enter into separate contractual arrangements with every individual which it wishes to bind. If sanctioned, 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 it. This allows the company to reorganise or restructure itself within a commercially realistic timetable and with a degree of certainty of outcome that would generally be unavailable if the company needed to negotiate and to reach agreement separately with every interested party. It also facilitates complex, multi-level restructurings where different classes of members or creditors are dealt with in different ways and for junior creditors, whose claims are, in reality, economically worthless, to be “crammed down”.

Where a compromise or arrangement is proposed by a company, the court may order a meeting of the members or creditors or of a class or classes of them to be convened to consider the proposal. If at the meeting(s) the proposal is approved by the requisite Statutory Majority, the scheme will be binding on all members or creditors whose rights are affected and on the company provided that the scheme is sanctioned by the court. The “Statutory Majority”, for this purpose, means the double majority of a majority in number (“the Headcount test”) representing 75% by value (“the Value test”) of members or creditors or of the classes of members or creditors present or represented and voting at the relevant meetings. The Statutory Majority overrides for the purpose of the approval of a Scheme any contractual provision which may prescribe any other voting threshold for amendment of the contract.

The Scheme therefore packs a powerful punch: capable as it is of rewriting rights and liabilities contracted for, and it is the twin requirement that the Statutory Majority approve the Scheme and the Court sanction it, which together give it that power.

The requirement that a Statutory Majority be achieved in favour of an arrangement originated in the 19th Century legislation and passed into law at a time when share and debt holders typically held their interests both beneficially and legally so that there was rarely a significant difference between the persons whose names appeared on the relevant register of interests and those ultimately beneficially entitled to those interests. In that context, the logic of the double majority makes sense: the purpose of the Headcount is to prevent a minority with a large stake prevailing over the wishes of the majority. The Value test prevents a numerical majority with a small stake outvoting a minority with a large stake. The balance was therefore struck between those with large economic interests (the majority in value) and those with smaller interests (the majority in number).

However, the Statutory Majority has in recent years come under increasing scrutiny, at least to the extent of the Headcount test. Both Hong Kong and Australia have amended their legislation so as to replace (Hong Kong) or to mitigate the effect (Australia) of the requirement that a majority in number support a Scheme proposed between a company and its members. The Headcount test has been criticised as being inconsistent with the principle of “one share one vote”, and as giving a small holder of shares or debt an influence on the outcome of the Scheme disproportionate to his economic stake.

It has also been criticised in its application to both member and creditor schemes as operating to the detriment of stakeholders who, whilst beneficially entitled to the debt or share, hold their interest through nominees, custodians or

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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.

1 Brooking J in the Supreme Court of Victoria in ANZ Executors and Trustees Ltd. v. Humes Ltd [1990] VR 615 at 622 summarised the dual majority test as follows:

“... the result is achieved that mere numbers on a count of heads will not carry the day at the expense of amount invested and on the other hand that the weight of invested money may not prevail against the desires of a sizeable number of investors.”

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trustees, each of whom counts as a single head for the purposes of the Headcount test, however numerous or valuable those whom he represents. This may be the case both in member schemes, for example, where uncertificated securities are held through intermediaries or a central clearing house, and in creditor schemes, for example, where bondholders hold through custodians or trustees.

As a matter of law, it is usually the case in such a situation that the only person entitled to vote on the Scheme is the person whose name appears in the relevant register as the holder of the share or debt instruments. Whilst, in relation to the value test, this makes no difference to the outcome of a vote, as the underlying value of the debt or securities held is calculated in reaching the totals cast, it does have an impact in calculating the persons voting from the point of view of the Headcount test.

Various approaches have been applied with the aim of resolving the conundrum which the Headcount test presents. At one end, these solutions have included the direct enfranchisement of the beneficial owners through the issuing of voting cards or certificates to all beneficial owners, or to those wishing to vote, recognising the beneficial owners as contingent creditors who are thus entitled to vote on the Scheme. Alternatively, amendments have been made to the terms of bonds so as to bring the holders within the statute as “creditors” who are thus entitled to vote on the Scheme. At the other end of the spectrum, recognising that a holder may cast parts of his vote in different ways, the legal owner has been treated as having two heads, one voting in favour and one against, thus cancelling each other out. Clearly, all of these solutions have their difficulties, legal and practical.

The neatest solutions have been those which seek to recognise the representative nature of the legal holder’s title and to give effect to the wishes of the beneficial owners, without ignoring the legal position that it is the legal title which confers the right to recognition for voting purposes. One such solution, adopted by the Royal Court in Jersey in the Computer Patent Annuities Holdings Limited Scheme, is for each share or debt holder to be allocated a single vote but for each such vote to be subdivided into fractions of a vote in accordance with the number of beneficiaries which are represented by that holder. Those fractions can then be voted by the holder for or against the Scheme and the fractions aggregated to determine whether the majority in number is for or against the Scheme.

The difficulty with this approach is that it is inconsistent with the traditional line taken by in Common Law jurisdictions where company law takes no notice of any trust or beneficial interests attaching to shares nor, usually, the terms under which debt instruments have been issued.

Another approach to a similar effect, but more satisfactory from a legal perspective, is to allow the custodian or nominee a single vote, either for or against, to be determined by his setting off the number of beneficiaries for whom he holds supporting the Scheme against those opposing, with the majority determining which way the single vote is to be treated as cast.

Undoubtedly, for as long as the Statutory Majority, including the Headcount test, remains a condition for the sanction of a Scheme, other approaches will emerge from time to time to deal with the issue which it raises in situations where shares or debt are held through nominees. In the BVI context, the issue is likely to arise with Schemes, as many expect them to prove the mechanism of choice for the compromise of competing rights of creditors and shareholders in the insolvent Funds. What is important, however, is that such solutions have been found, tested and accepted in different circumstances so that those wishing to use the Scheme in complex restructurings, solvent and insolvent, both in the BVI and elsewhere, can be confident that they are available and that the Headcount test presents no obstacle to the success of an otherwise well-founded proposal.

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2. In 2006, during the consideration by the UK Parliament of what became the Companies Act 2006, two attempts were made to remove the majority in number requirement with respect to Schemes. On the first occasion (House of Lords Hansard, 28 March 2006, column GC326), the Attorney general said that Government said that the Government was not persuaded that the amendment struck the right balance between small and large stakeholders. The second attempt House of Lords Hansard, 16 May 2006, column 217, put forward on the footing that “the majority in number, focusing on a majority of registered holders, is an anomalous, now that most retail holders hold through the CREST nominees, where one registered holder may represent many thousands of beneficial owners. It is also open to abuse by shareholders who could subordinate their holding through a number of nominee companies.” Again, the Government’s response was that removal of this requirement would mean that “larger creditors and members could impose their will unfairly on smaller creditors and shareholders”.

3. Which was the approach permitted by Hart J in Re Castle Holdco 4 Limited (unreported) in connection with the Countrywide Pico Scheme and by the Royal Court of Jersey in Investkredit Funding Limited [2012] JRC 121.


5. [2010] JRC 011

6. As recognised by Cresswell J in the Grand Court in Cayman in Re Alibaba.com (unreported) 20 April 2012.

7. canvassed but rejected by the Grand Court in Cayman (Jones J) in Re Little Sheep (unreported 20 January 2012) for reasons arising out the particular terms of the applicable Practice Direction.