WHITE & CASE

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APCOA – The Key Highlights of 2014's Most Discussed Scheme

On 30 October 2014, the English High Court sanctioned the second scheme of arrangement for the APCOA group (the "**Scheme**"). APCOA has been one of the hottest names in the restructuring market in 2014. First, it broke new ground in relation to an "amend and extend" scheme in early 2014 when it established sufficient connection to England off the back of a change in governing law. Second, the Scheme was aggressively opposed and its sanction by the High Court was appealed to the Court of Appeal (although ultimately the appeal was withdrawn).

It is unusual that a scheme is challenged, largely because companies are hesitant to launch a scheme process in the face of known opposition. The absence of creditor challenge has meant that the terms of schemes are rarely tested to such an extent. Below we consider the key issues examined by the Court in this case.

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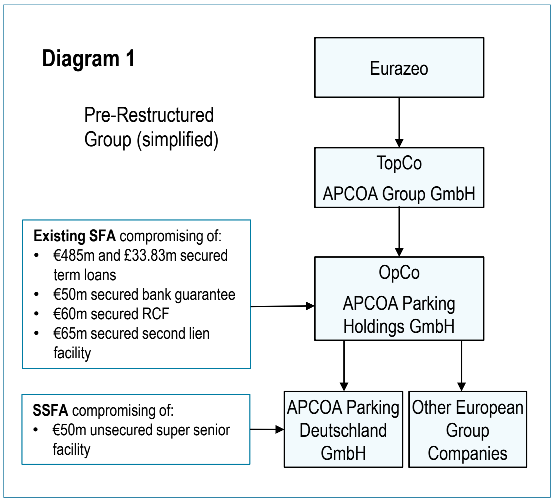
Background

The APCOA group is a leading car park operator managed by its German parent, APCOA Parking Holdings GmbH, with operations across Europe.

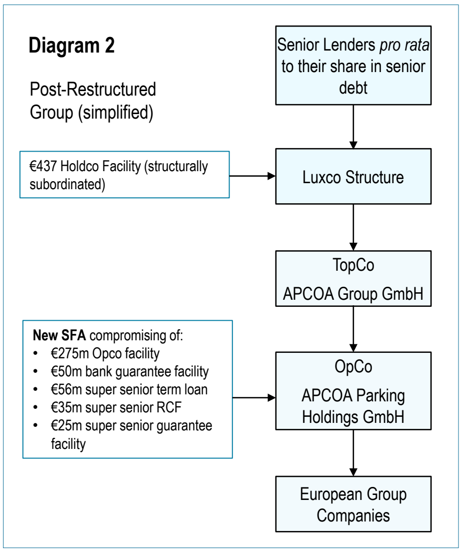


Following the loss of its cash pooling arrangements in November 2013, emergency funding was provided to the APCOA group under a super senior facility agreement (the "**SSFA**") by certain lenders under its existing senior secured facilities agreement (the "**Existing SFA**") (see diagram 1). The SSFA was provided on an unsecured basis on the understanding that those lenders would enter into a turnover agreement with two APCOA entities (the "**Turnover Agreement**"), whereby they would pay all monies received under the Existing SFA to the SSFA lenders, until the SSFA was repaid in full.

The facilities under the Existing SFA and SSFA were originally due to mature on 25 April 2014, but the group extended the maturities to 25 October 2014 using a scheme of arrangement that was sanctioned on 14 April 2014 (the "**Extension Scheme**"). This extension was designed to give the group more time to conclude negotiations with its creditors and implement a full restructuring.

The Restructuring

The restructuring of the APCOA group has seen the refinancing of €275m outstanding under the Existing SFA as well the €50m bank guarantee facility by entry into a new senior facilities agreement (see diagram 2). The remaining €437m of indebtedness has been hived up to a new Luxco structure on a structurally subordinated basis in order to deleverage the balance sheet of the German OpCo.



APCOA held its scheme meetings on 13 November 2014, where the Scheme received the overwhelming support of each class of scheme creditors. However, certain dissenting creditors sought to challenge the terms of the restructuring and opposed the Scheme at both the directions hearing and the sanction hearing. Whilst the Scheme was sanctioned by the High Court, an appeal to the Court of Appeal was launched. This appeal was ultimately withdrawn.

Sufficient Connection

In April 2014, APCOA made headlines when it launched the Extension Scheme having sought to create sufficient connection by amending the governing law of the Existing SFA from German to English law using majority lender consent. At the hearing of the Extension Scheme, this point was noted to the Court by various creditors but went unchallenged. However, this time around, opposing creditors argued to the Court that there was insufficient connection because there was no "legitimate interest" underpinning the change in governing law.

As with the Extension Scheme, the Court held that provided the contractual provisions had been complied with, it did not matter whether the finance parties chose English law on day 1 of the financing or just before a restructuring process. This fact does not change the ability of the English court to compromise rights under English law governed documents.

Sufficient Connection

The English court has jurisdiction to sanction a scheme for a foreign company if it is satisfied that the company has a sufficient connection with the English jurisdiction. Typically, as seen in *Re Magyar Telecom* [2013] EWHC 3800 (Ch) and *Re Zlomrex International Finance* [2013] EWHC 4605 (Ch), this is established by shifting a company's centre of main interest to the UK or where the rights that are being compromised are under English law governed finance documents, as seen in *Re PrimaCom* [2012] EWHC 164 (Ch) and *Re Rodenstock* [2011] EWHC 1104 (Ch).

Majority Rule?

Schemes have become the international restructuring tool of choice in part because of their flexibility and the wide meaning of "arrangement" – from amend and extends to debt for equity swaps, schemes are being used to implement increasingly sophisticated "compromises" that are limited only by the imagination of a company and its advisers. The reluctance of the Court to second guess the decisions taken by sophisticated finance parties has drawn some in the market to conclude that the court process is a mere rubber stamping exercise – that provided the requisite majorities support the commercial deal, the court will seek to give effect to the agreement reached by those parties.

However, in the face of opposition, the Court was forced to examine in detail certain terms of the Scheme. Under the spotlight was a new guarantee facility that sought to replace an existing guarantee facility on substantially the same terms. The dissenting creditors argued that this facility imposed a new obligation that would see them having to indemnify the issuing bank if the relevant guarantees were ever called.

Despite both APCOA and the majority viewing this as a necessary part of the "give and take" nature of a compromise, the Court considered the imposition of new obligations to be a novel aspect not seen in any previous scheme. It held that an "arrangement" must vary creditors' existing rights – it was not a means by which creditors could be forced to undertake further obligations that could result in the outlay of new money. In the first instance, the Court refused to sanction the Scheme until this imposition was removed. Fortunately, APCOA was in a position to make this an elective facility, thereby overcoming the obstacle to the Court's blessing.

The implication of this on future schemes remains to be seen. The Court was careful to note that this ruling should not cast doubt on mere extensions or roll-overs involving more extensive obligations such as in the case of RCFs. However, companies should be mindful of this decision when designing their schemes, particularly if there is a creditor challenge on the horizon.

Class Composition

A scheme must be approved by at least 75% in value and a majority in number of each class present and voting. This means that class composition is key to the success of a scheme. Get it wrong and a company could be handing out a veto right to hold-out creditors. The opposing creditors to the Scheme argued that they should be in a separate class and when that failed, that the classes had been unfairly constituted. At the heart of the issue was whether the existence of the Turnover Agreement and a standard lock-up agreement was enough to create significant differences between those lenders who had entered into them (the "**Consenting Lenders**") and those who had not.

Whilst any agreement between some but not all creditors and a company may be enough to create class issues, it will always be a question of degree. The Court held that neither agreement could reasonably have been considered to have, as a matter of substance, altered the rights of the Consenting Lenders against the APCOA group. In addition, it held that any differences that did exist were not so significant as to be able to influence the way in which lenders voted on the Scheme.

The basis for this conclusion was that the purpose of the restructuring was to safeguard the future of the APCOA group and to facilitate the repayment of the €660m owing to the lenders under the Existing SFA. This interest substantially outweighed any other separate interests that the lenders may have had. When considered in context, it was not credible to suggest that the SSFA, the Turnover Agreement or the lock-up agreement and any divergent interest stemming from them would have been of significance when informing the way the majority voted, given the sheer amount of debt outstanding under the Existing SFA. On the evidence, the Court found that, as established in *Re Hawk Insurance* [2001] 2 BCLC, there was more uniting than dividing the Consenting Lenders and non-Consenting Lenders and the threat of imminent insolvency should have caused a rational and reasonable creditor to unite in a common cause.

Class Manipulation

In order to ensure the success of a scheme, companies try and ensure that classes are constituted in a way that minimises the ability of opposing creditors to vote the scheme down. However, there are clearly limits on how far a company can go in its attempts to influence class formation. There must be some kind of logic behind the grouping of different creditors. This is not a precise science. As established in *Re Hawk*, the starting point is to identify whether there are any differences in the legal rights of creditors against the company, and if there are, consider, by reference to the alternative if the scheme were to fail, whether objectively there would be more uniting than dividing the creditors in a proposed class.

In relation to the Scheme, the dissenting creditors sought to argue that the termination of the Turnover Agreement was done to remove the difference between the Consenting and non-Consenting Lenders in an attempt to overcome potential class issues. It is hard to dispute this, and indeed the Court did not. However, the Court held that, in this instance, the attempt to preclude a class issue was not an objectionable manipulation.

Recognition Abroad

Where schemes involve foreign companies or foreign assets, the English courts will also consider the effectiveness of the scheme abroad before exercising their discretion to sanction it. This is particularly complicated when there is a risk that a restructuring may breach the laws of another jurisdiction. In the case of APCOA, an argument was raised by the dissenting creditors that the release of the transaction security under the German law governed intercreditor agreement, which was a crucial part of the overall deal, would result in a breach of contract.

In such circumstances, it is not for the English courts to decide matters of German law - they just need to be satisfied to the greatest extent possible that there is no obvious breach of law. On the basis of the evidence presented, the Court was comfortable that there was not a sufficient basis for declining to sanction the Scheme. However, Hildyard J did require that the Scheme was amended to make it clear that nothing prevented a creditor from bringing legal proceedings in Germany in relation to any rights parties could argue they have under the intercreditor agreement.

Conclusion

For the past 18 months, the market has speculated as to which foreign company would be the first to seek to create sufficient connection to England by amending the governing law of its finance documents. While ultimately the Scheme was challenged on numerous grounds, the real interest for the market was whether this basis would be upheld by the Court and therefore whether other companies would follow suit in the future. Following the Court's judgment, we can expect that other foreign companies will use APCOA as a precedent to establish sufficient connection off the back of a change in governing law.

While the change of governing law is what the APCOA schemes may largely be remembered for, it is important to highlight the other key observations that have resulted from the Scheme. First, despite overwhelming creditor support and the threat of imminent insolvency, the Court could not be persuaded that it was within its jurisdiction to impose new obligations. Second, it also reaffirmed how reluctant the court is to separate creditors into different classes without a clear reason as to why the relevant groups of creditors ought not to be able to consult together with a view to their common interest. Whilst it is for the court to ensure that the minority are not being coerced, schemes are primarily a tool to ensure that the majority are not held to ransom. The existence of different rights is not enough to affect class formation – the significance of those differences must be looked at in the wider context and only the most compelling arguments will persuade the court to give a veto right to dissident creditors.