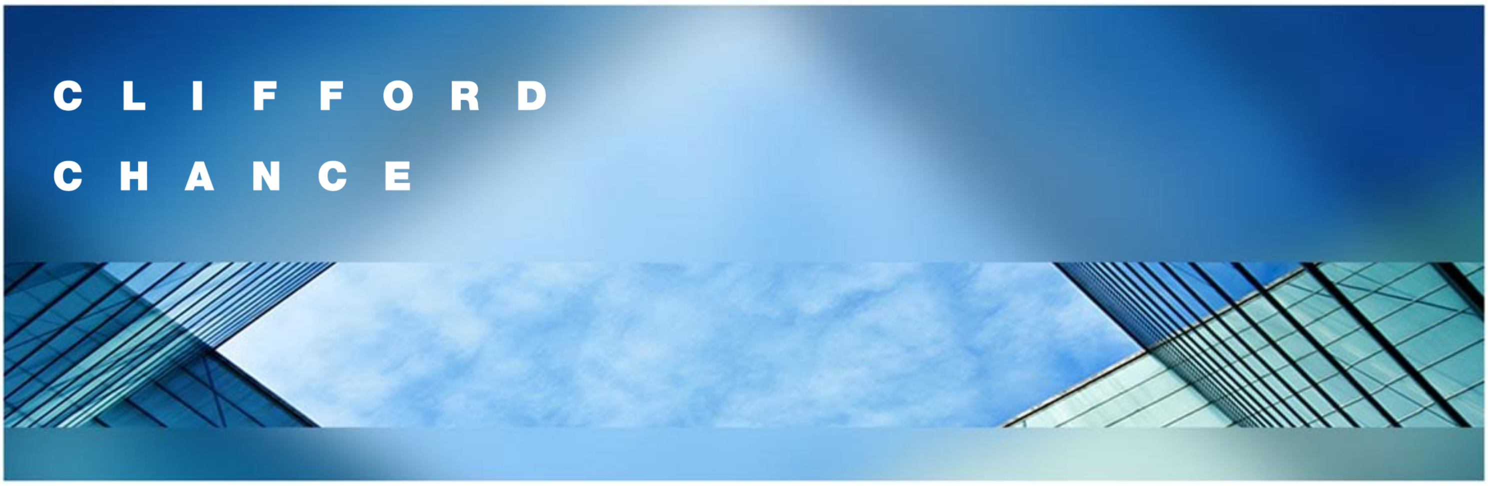

USING A SCHEME OF ARRANGEMENT TO SETTLE COMPLEX GROUP LITIGATION AND IMPLEMENT CONSUMER REDRESS: LINK FUND SOLUTIONS LIMITED

Leading international law firm Clifford Chance has advised Link Fund Solutions Limited ("**LFSL**") on resolving potential liabilities relating to the LF Woodford Equity Income Fund (the "**WEIF**") through a UK scheme of arrangement (the "**Scheme**"). The Scheme was proposed pursuant to a conditional settlement with the FCA, and will see approximately 250,000 "**Scheme Creditors**" share between £183.5 million and £230 million out of a settlement fund. In return, the Scheme Creditors release any claims they may have against LFSL. In particular, the Scheme compromises group litigation against LFSL led by three claimant firms representing over 20,000 Scheme Creditors, and prevents all other Scheme Creditors from bringing equivalent claims.

Key issues

- English court blesses UK scheme of arrangement that compromises liabilities relating to the LF Woodford Equity Income Fund
- Demonstrates the versatility of schemes of arrangements, used in this case to effectively and efficiently compromise group litigation
- Provides important lessons for other companies facing, or potentially facing, group litigation or regulatory redress, as well as for litigants and their funders.
- First scheme to use an innovative "Third Party Litigation Deed" structure that allows scheme creditors to preserve claims against third parties to the maximum while releasing the scheme company

The Scheme was supported by almost 94% in number, and 96% in value of Scheme Creditors who voted, but was opposed in Court by certain of the claimant law firms, and by a consumer group and the Scheme Creditors associated with that group. Rejecting all of the arguments raised against the Scheme, the Court confirmed the application of longstanding principles to the facts of this case.

The Scheme provides important lessons for other companies facing, or potentially facing, group litigation or regulatory redress, as well as for litigants and their funders. It is also the first to use an innovative "Third Party Litigation Deed" structure that allows Scheme Creditors to preserve claims against third parties to the maximum extent possible, notwithstanding the release of their claims against LFSL.

Background

- **LFSL:** LFSL was formerly the UK's largest host authorised corporate director of UCITS funds, which collectively managed c. £90 billion in assets.
- **The WEIF:** One of those funds was the WEIF.

- **FCA Investigation:** The WEIF was suspended on 3 June 2019, following which the FCA launched a formal investigation. On 21 September 2022, the FCA announced its conclusion that LFSL should pay redress in an amount of £306 million (subsequently reduced to £298m). LFSL disputed all liability.
- **Claimant firms:** In addition, three claimant law firms claiming to represent over 20,000 Scheme Creditors issued, and in some cases served, claims against LFSL. LFSL again disputed all liability.
- **Settlement with the FCA:** On 23 April 2023, LFSL entered into a conditional deed of settlement with the FCA and LFSL's ultimate parent entity. The settlement provided for the proceeds of the sale of LFSL's business, together with a sale of certain affiliated businesses, to be applied to fund redress to Scheme Creditors. Additional resources would come from claims under LFSL's insurance policies and cash on LFSL's balance sheet.
- **The sale:** The sale of LFSL's business completed in October 2023.

Schemes of arrangement

- **What is a scheme?** A scheme of arrangement is a procedure under the UK Companies Act 2006, though with precedent stemming back to the Victorian era. It allows a company to enter into substantially any arrangement or compromise with its creditors, shareholders, or any class of them, provided that the scheme is (a) approved by a majority in number, representing 75% in value, of the relevant creditors or shareholders who are present and voting at a meeting convened by the Court; and (b) "sanctioned" (i.e. approved) by the Court.
- **Scheme process and court hearings:** There are three key stages in a scheme process. First, a court hearing is held to decide whether to call creditors to vote on the scheme – and if so, how they should vote. This hearing is referred to as the "convening hearing". Second, a creditors' meeting is held to vote on the scheme. An explanatory statement, explaining the Scheme's terms and effects, must be circulated ahead of the meeting. Third, a further court hearing is held to decide whether to sanction the scheme – the hearing is referred to as the "sanction hearing".
- **How do schemes compare with restructuring plans?** Restructuring plans are a more recent restructuring tool, based on schemes of arrangement. There is no "majority in number" requirement for a restructuring plan, and restructuring plans also allow the court to "cram down" dissenting classes in certain circumstances. However, restructuring plans are only available where a company is experiencing or likely to experience financial difficulties. There is no such requirement for schemes of arrangement. Although they can be used by insolvent companies, schemes of arrangement are not insolvency proceedings.

LFSL's Scheme

- **The Scheme Creditors:** LFSL proposed its Scheme with everyone who held shares in the WEIF at the time of its suspension, or to whom they had transferred their claim. LFSL estimated that there were approximately 250,000 Scheme Creditors.
- **Payments to Scheme Creditors:** Most investors in the WEIF held their shares through intermediaries (such as online investment platforms or

brokers) and so LFSL did not have direct contact with underlying Scheme Creditors. Under the Scheme, LFSL will make a payment to the WEIF for onward distribution down the chain of beneficial owners to the ultimate Scheme Creditors. The process for payments is similar to that which has been used for many years on bondholder schemes.

- **Disputed claims:** LFSL continued to dispute all liability to the Scheme Creditors until the Scheme became fully effective (at which point, it accepted liability for the purpose of the Scheme only). The Court followed an extensive line of authority in holding that disputed claims could be compromised by schemes. Scheme Creditors' claims were valued in accordance with the redress methodology proposed by the FCA.
- **Third Party Litigation Deed:** It is common for schemes to release third parties (in addition to the company proposing the scheme) where those releases are "necessary and ancillary" to the scheme. This will often include giving releases to guarantors forming part of the same corporate group. Such guarantors will often face serious risks to their own solvency if their guarantee obligations are not released. Moreover, if a claim were made under the guarantee, the guarantor would in turn be able to bring a claim against the scheme company for a contribution (a "**contribution claim**") – potentially rendering the scheme ineffective. LFSL faced the unusual situation of potentially being liable for disputed claims alongside unaffiliated third parties. Releasing the third parties could have left Scheme Creditors worse off than if they were to successfully claim against the third party, but those third parties might then bring contribution claims against LFSL. To resolve this, the Scheme puts in place a Third Party Litigation Deed which (in summary) establishes a trust over claims against third parties which may result in a contribution claim against LFSL. The proceeds of any relevant claim are then applied in accordance with a waterfall that sees LFSL recover the amount of any contribution claim before amounts are paid to the claimant. LFSL can in turn set-off its own recoveries against any contribution claim made against it. The Scheme therefore preserved claims against third parties to the maximum extent possible whilst allowing LFSL to remain solvent and make the maximum possible payment to Scheme Creditors.

Class arguments

- **Class:** When voting on a scheme of arrangement, creditors are divided into "classes" by reference to the similarity or otherwise of their legal rights. Each class needs to approve the scheme – otherwise the court does not have jurisdiction to sanction it.
- **Retail vs non-retail:** At the convening hearing, the claimant firms and certain retail investors argued that "retail" creditors should vote in a separate class from "institutional" creditors. The primary argument was that retail creditors would have recourse to the Financial Services Compensation Scheme ("**FSCS**") if the Scheme were to fail, which *could* result in retail investors receiving a larger payment than was offered under the Scheme – albeit there was no certainty. Institutional investors (on the other hand) would not receive that payment. The effect would have been that retail or institutional creditors would each have had a "veto" on LFSL's Scheme.
- **A single class:** This was the first time that a scheme opponent had argued that rights against the FSCS could fracture a creditor class.

However, the Court followed the reasoning of Lord Millett in *Re UDL Holdings* [2002] 1 HKC 172 in holding that rights against a third party – including therefore the FSCS – would not fracture a class for voting. This meant that neither retail nor institutional creditors as a constituency would have a strict "veto" over the Scheme. However, how different types of creditors voted would still be relevant to the Court in exercising its discretion as to whether to sanction the scheme.

Discretion, fairness, and jurisdiction

- **Discretion:** The Court is not obliged to sanction a scheme that has been approved by creditors – the Court has a discretion as to whether to do so. The key question that the Court asks at the sanction hearing relate to fairness: was the class fairly represented at the meeting, and is the Scheme fair on its terms? The court also needs to be satisfied that it has jurisdiction to sanction the scheme.
- **Fair representation:** Over 54,000 Scheme Creditors voted on the Scheme following an extensive print, online, and television advertising campaign; and the Court concluded that the class was fairly represented. Moreover, both retail and non-retail Scheme Creditors overwhelmingly supported the scheme by well in excess of the statutory majorities. A claimant firm and a consumer group sought to cast doubt on the vote, arguing that the explanatory statement was misleading; but the Court rejected these arguments.
- **Fair scheme:** A claimant firm and a consumer group argued that the Scheme was "unfair" because (among other things):
- the Scheme would prevent claims against third parties in practice (there was no evidence that it would);
- the Scheme would remove Scheme Creditors' rights to refer their claims to the Financial Services Compensation Scheme and thereby receive a 100% recovery on their claim up to the FSCS' £85,000 cap (this argument was rejected, as LFSL successfully argued that there was no certainty that Scheme Creditors would in fact be able to establish a claim against FSCS were the Scheme not to be implemented);
- the Scheme failed to distinguish between retail and non-retail creditors (this did not render the Scheme unfair); and
- the Scheme did not distinguish between creditors who had brought claims and those who "sat on the sidelines" (again, this did not render the Scheme unfair).

"Fairness" for a scheme does not mean that it needs to be the "best" scheme, just that it is one that an intelligent and honest person could approve having regard to their own interest.

- **Jurisdiction**:
    - **Disputed claims:** Certain Scheme Creditors argued that the court lacked jurisdiction to sanction the Scheme, even if it wanted to, because LFSL did not accept liability to the Scheme Creditors. They therefore argued that Scheme Creditors were therefore not "creditors" in the ordinary sense of the word. The Court rejected this argument – as has long since been established, disputed creditors are creditors for the purposes of schemes.

  - **Financial Ombudsman Scheme:** A consumer group also argued that the Court lacked jurisdiction to approve the Scheme because the effect of the Scheme would be that certain Scheme Creditors could not refer claims to the Financial Ombudsman Scheme ("**FOS**") and the right to recover from the FSCS, and to refer claims to the FOS were expressions of public policy that could only be compromised with express statutory authority. The Court rejected these arguments: in short, the Scheme compromised underlying claims, which meant that there was nothing to refer to the FOS or to be compensated by the FSCS, and so the arguments raised against the Scheme were misconceived.

- **Appeal:** The consumer group opposing the Scheme sought permission to appeal from the High Court. The High Court found that none of the grounds for appeal had realistic prospects of success, and that there was no other compelling reason for an appeal to be heard.

Implications

- **Implications for other firms facing group claims:** For companies targeted by group claims, settlement carries the risk of follow-on claims from other litigants looking to "piggy-back" off the settlement. This often means that settlement is not a viable option. Compromising claims through a Scheme mitigates that risk, as the Scheme can settle the claims of all potential claimants within the class, whether they voted for the Scheme or not. The Link Scheme is a clear illustration of how the tried-and-tested principles that underpin the UK restructuring regime provide significant flexibility, and allow companies to restructure in the interests of all parties. Following the success of the Link Scheme, we expect to see companies increasingly making use of schemes of arrangement to effectively and efficiently compromise group litigation. Schemes also allow companies to avoid the "taint" of insolvency, though there may be cases where the additional flexibility of a restructuring plan is important.

- **Implications for litigants and funders:** Claimant groups, and their funders, should also bear in mind the potential for a scheme or a restructuring plan to be used to settle their proceedings at an early stage. Successfully challenging a scheme or plan proposed by a well-advised company can be difficult (though not necessarily impossible), and timely and proactive engagement may be a better strategy.

Tim Lees and Philip Hertz led the team advising on LFSL's Scheme, together with Jeanette Best, William Steel, and Emma Buchanan. Partners Ian Moulding and Carlos Conceicao led the Litigation & Dispute Resolution team, together with Jason Epstein, Ryan Byrne, Lydia Tuckey, and Claudia Martinez-Madrid. Chris Ingham and Ryan Byrne advised on insurance matters. Alanna Hunter led on the sale of LFSL's business, together with Dan Bomsztyk, Caoimhín Eastwood, Alice Butcher, and Mitchell Paul.

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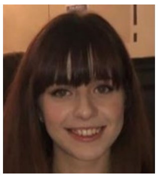

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