SQUIRE PATTON BOGGS

The Evolution and Anatomy of Restructuring Plans

UK – July 2023

Snapshot

The Restructuring Plan (Plan) was introduced as part of the UK Corporate Insolvency and Governance Act 2020, which introduced a new part 26A into the Companies Act 2006 (CA 2006). The part 26A Plan provisions are largely based on the existing scheme of arrangement rules detailed under part 26 of the CA 2006, and it is often referred to as the "super scheme".

Plans now sit alongside schemes of arrangement and company voluntary arrangements (CVAs) to provide a further restructuring option for companies and insolvency practitioners alike.

The original intention behind the Plan was to help combat the economic impact of the COVID-19 pandemic; however the concept of a Plan had been in the offing for some time and it was not intended as a temporary measure solely for this purpose. It was also intended to combat perceived shortcomings in the existing insolvency framework, such as the inability to bind secured creditors to a CVA and the lack of cross-class cram-down power in schemes of arrangements. The terms of each Plan will be different and tailored to each individual company circumstance, much like a CVA or scheme is.

A Plan may take many forms, including:

- A compromise in the amount of debt
- A debt for equity swap
- Rescheduling debt repayments/amending terms
- Restructuring landlord liabilities

Eligibility

The government's response in August 2018 to the original Insolvency and Corporate Governance consultation made it clear that a Plan should be available to all companies. The availability of a Plan is not dependent on the company's size or turnover.

The threshold for a Plan is that:

- The company must be one that is liable to be wound up under the Insolvency Act 1986. In broad terms, the Plan is available to the same constituency of companies as would otherwise be in a position to utilise a scheme of arrangement. Crucially, there is no requirement that the company's centre of main interests is in the UK;
- It is only available in order to eliminate, reduce, prevent or mitigate the adverse effect on a company's ability to carry on business as a going concern caused by serious "financial difficulties" that the company has encountered or is likely to encounter. There is no requirement that the Plan should seek to continue the company's business as a going concern. This is in comparison to a scheme of arrangement, where there is no requirement for the company to be in financial distress.

Process

Negotiation

Practically, the first step for a Plan is the negotiation of the terms with key creditors and drafting the requisite documentation. Typically, this can take a number of months while the commercial negotiation takes place. This can be a lengthy and complex process, depending on the nature of the creditors, the debt and the jurisdictions involved.

Practice Statement Letter

Usually, the company will send a "practice statement letter" to all affected creditors and members 14 days before the convening hearing (Convening Hearing) to give them an opportunity to appear at the hearing and contest the classes if necessary.

The practice statement letter will set out the proposed claims for the purpose of the Plan and the reasons why the company considers such classes to be appropriate, together with how their rights will be impacted by the Plan.

Convening Hearing

Once the Plan documentation has been drafted, there will be a court hearing to determine class composition and jurisdiction, and to convene meetings of creditors and members.

At the Convening Hearing, the court must be satisfied that the jurisdictional requirements of section 901A of the CA 2006 are met so that it has the power to sanction the Plan if approved at the meetings.

If jurisdiction is established, the court will consider the proposed voting classes and how many meetings need to be convened. Broadly, creditors and members will vote in the same class where their rights are tied to a common interest.

At the *Virgin Atlantic* Convening Hearing, it was noted that certain creditors can be excluded if their claims are not compromised under the Plan. However, it was further clarified that companies do not have free range to just pick and choose which creditors they wish to include within a Plan – they must be able to consult together with a common interest.

In *Re Garuda*, it was noted that there must be legitimate commercial reasons for selecting which creditors are subject to a Plan and full disclosure of any other similar creditors which are not subject to the Plan. In this case, it was held that there were legitimate commercial reasons to exclude certain creditors (of under £50,000) which was mainly due to the severity of the time and costs burden of including them.

Explanatory Statement

In order for the court to properly consider creditor classes, the company will need to provide an accompanying "explanatory statement" to the Plan, detailing the existing rights of creditors and/or members, and how these rights will be impacted by the Plan.

The length of the explanatory statement varies greatly and is dictated by the nature of the restructuring. It does not necessarily depend on the size on the company, rather the nature of the proposed Plan in place.

Past precedent shows us that this can vary greatly. In *ED & F Man Limited*, the statement ran to thousands of pages, and the company appended all the Plan documents and reports as to the relative alternative within the document. However, in *Virgin Active,* the statements were relatively short. In *GoodBox*, it was also noted that, although the financial estimates were sparse, they still identified the risks, and that detail must be judged in the context of the urgency, size and nature of the company's business and the state of the information readily available at the time. That said, *GoodBox* is an unusual example as the Plan was proposed by one of its creditors.

The courts' comments in *Re All Scheme Limited* (although in the context of a scheme of arrangement) welcomed a relatively short explanatory statement in plain language, which was comprehensive and practical with diagrams and charts. This is equally applicable to Plans. The courts have stressed the importance of full and frank disclosure being made by the company both to the court and to creditors/members so they can assess whether the Plan is in their interest.

Order Authorising Creditor Meetings

If the court accepts jurisdiction and class constitution, then it will make an order authorising the company to convene meetings of creditors and members, as appropriate. Once documents have been made available to affected creditors/members, there will usually be a period of around 21 days for the creditors/members to consider the proposed Plan before the meetings take place. The creditors/members will then formally vote on whether they accept or reject the proposal. The requirement for approval is a 75% majority in value, of those voting, of each voting class.

Sanction Hearing

The second court hearing is to determine whether to sanction the Plan (the Sanction Hearing). The Sanction Hearing will usually take place a few days after the meetings have been held. The court will consider whether the required statutory majorities of creditors/members voting in favour of the proposal have been reached.

Plans benefit from a "cross-class cram-down" provision, a two limb "no worse off" test, which allows the court to sanction the Plan as binding even if a dissenting group in a class of creditors or members results in the Plan not being agreed by 75% in value of that class.

If the court decides to exercise its discretion to sanction the Plan and the order is registered at Companies House, then the Plan will become binding on all the creditors/members affected by it. This includes those who voted against it, did not vote at all and even those who did not receive notice of the Plan.

It is important to note that the court may refuse to grant sanction notwithstanding satisfaction of all the procedural requirements if it considers that the Plan is not just and equitable. In a recent case the court refused sanction even though procedurally it could have crammed down HMRC as the dissenting creditor. The court chose not to exercise its discretion stating that this was in the interests of fairness.

Time Frame

The time frame for a Plan can vary greatly depending on the circumstances. Generally speaking, based on the Plans that have been launched to date, the average length of time from the practice statement letter release to the Sanction Hearing is approximately 10 weeks.

However, there can be large variability in the timeline for a Plan, and, if the facts dictate like they did in *GoodBox*, the time frame can be relatively short. The *GoodBox* Plan demonstrated that the process can be completed in an accelerated timetable where there is a genuine urgency to do so. This was also seen in the *Virgin Active* and *Virgin Atlantic* cases, which were approximately seven weeks, while, in comparison, the complex *Gategroup* Plan was closer to 15 weeks.

The time frame is heavily dependent on information to hand, negotiation with the creditors, and the adequacy of information, together with the length of time creditors have to assess the information. As is often the case at this stage, information, time and liquidity can be in short supply when a company is encountering or expecting to encounter financial difficulties.

What Do Restructuring Plans Achieve?

The Plans that have been implemented since the legislation took effect have demonstrated inherent flexibility. However, the full potential of the Plan is still being explored.

Practically speaking, it seems that a Plan is a more viable option for larger complex companies given the costs associated with the process. Typically, and thus far, Plans have been used by larger corporates with average revenues of circa £700 million. To date, the types of companies/industries that have been restructured using a Plan have been widespread, and it seems that the Plan can suit all types of industry/sector. The aim is for Plans to be more accessible to smaller companies in the future who otherwise historically might have used a CVA.

The Court's Approach

It is important to note the court's approach to date on the key elements of Plans as this ever- evolving insolvency tool finds its place in the market. Where possible, it seems that the courts are leveraging precedents set by schemes of arrangements, but they are laser-focused on procedural fairness and the level of evidence provided by companies, particularly when it comes to the relevant alternative.

Cross-class Cram-down

The cross-class cram-down mechanism works where the two statutory thresholds of the "no worse off in the relevant alternative" test are met, but, ultimately, the court maintains its discretion to sanction a Plan. One of the key considerations when deciding whether to exercise this discretion is fairness, and the distribution of the restructuring surplus (see below) will be a highly relevant factor.

This power is one of the most revolutionary aspects of a Plan, giving it an advantage over schemes and CVAs, but also, because of the effect of cram-down, it binds dissenting creditors – ultimately, the court retains discretion and can refuse to sanction a Plan even if the statutory requirements have been fulfilled.

DeepOcean was the first UK landmark cross-class cram-down case. The power has also been used to cram down British Business Bank in the *GoodBox* case, which was the first creditor-proposed Plan and the first case of its kind dealt with by the court outside of London.

In July 2022, the court sanctioned a Plan proposed by Houst Limited. Houst was an SME that managed a property/holiday let business that was badly affected by the pandemic. This was the first case where the court used its power to cram down HMRC as a dissenting creditor. However, the recent decisions of *Great Annual Savings* (*GAS*) and other cases made it clear that a Plan is not to be used to escape unpaid tax bills and that there needs to be a good (and justifiable) reason to cram down HMRC, which – in alternative insolvency processes – benefits from being a secondary preferential creditor. *GAS* was actively opposed by HMRC and the court for various reasons refused to sanction the Plan.

GAS reinforces a key message from *Re Smile Telecoms Holdings Limited* that, if a creditor wishes to challenge a Plan, it must play an active role. It will not do to object from the side-lines, they should attend the Sanction Hearing and (if appropriate) submit evidence in opposition. HMRC are adopting an increasingly active stance in challenging Plans which they deem to be unfair on the UK taxpayer.

Most recently however the Plan by *Prezzo* was sanctioned and HMRC (who voted against the Plan as both preferential creditor and unsecured creditor) were crammed down. This was HMRC's first defeat when actively opposing a Plan. *Prezzo* initially intended to pay £1.32 million to HMRC – equivalent to what HMRC would receive in the relevant alternative – but the company increased the sum to £3.3million following the convening hearing. In effect this meant that HMRC would receive a payment equivalent to 150% of its preferential debts, compared to what it would otherwise receive if the company went into administration. The court was happy that the Plan was not being used as an 'instrument of abuse', the company had not been trading 'at the expense of HMRC' and that the plan was a fair one in the circumstances. Perhaps a big takeaway from this case is that the court did not find that HMRC was a critical creditor and should have been paid in full whilst the plan was being proposed. Had the judge concluded that HMRC should be paid as a matter of principle before a court would consider sanction, this would have had a significant impact on future plans. The judge was willing to accept the company's reasons for not paying – to preserve the value in the business. However, although HMRC was not considered to be a critical creditor in Prezzo, its "special status" and position as preferential creditor still needs to be considered in the context of whether it is a critical creditor in future plans.

It is not just HMRC that have been crammed down in recent weeks either. *Fitness First* proposed a Plan following in the footsteps of its competitor Virgin Active that was met with strong opposition from landlords. The Plan compromised the accrued liabilities of certain landlords and the future obligations of the company under those leases amongst other points. This Plan was also sanctioned by the Court and the landlords were crammed down.

Cram across / Cram up?

Houst addressed "cram-down" and "cram-across" competing classes. The next question on the development of Plans will be how the court will address the question of "cramming up", where a junior creditor is the approving class, and that approval is used to cross-class cram down a more senior creditor. The approach of the court in *GAS* and *Prezzo* with the focus on fairness, suggests this will be an overarching factor if this is tested before a judge.

In practice however, this may be more difficult as the court will need to be satisfied that the senior class is no worse off than in the relevant alternative and that the junior class has a genuine economic interest in the relevant alternative. The court will clearly focus on the order of priorities in the relevant alternative in determining whether the allocation of any restructuring surplus is fair and, therefore, whether to use its discretion to sanction a Plan and utilise cross-class cram-down/-up/-across.

Underfunded defined benefit pension schemes are one of the few remaining typical restructuring stakeholders yet to be crammed down – however, this is perhaps a much more challenging stakeholder given the effect of the Pensions Scheme Act 2021, which potentially imposes criminal liability on those who seek to restructure to the detriment of the pension scheme.

Cases to date have shown that the court is willing to cram down dissenting creditors, but one of the key factors in persuading the court to exercise this power, as well as meeting the necessary statutory conditions, is fairness. Therefore, Plan proponents will need to have this firmly in the forefront of their minds when proposing a Plan.

Notice

Creditors ideally should have sufficient notice of the hearing to allow them to consider what is being proposed, to take advice if necessary and attend the hearing – usually 28 days. What constitutes "sufficient", like with many other factors in Plans, is heavily dependent on the circumstances.

In cases of commercial urgency, the court has been prepared to convene creditor meetings at short notice. Despite this, it is highly unlikely the court will allow short notice as a matter of course, unless there is real evidence of urgency and there have been genuine attempts in good faith to engage with key creditors.

Procedurally, it was held in *GoodBox* that the lack of available email addresses for 7% of members was not fatal, and the court noted that it is unusual, where there are many shareholders, for all of the shareholders to receive notice of the meetings because, inevitably, there will be members with out-of-date contact details or members that are deceased.

Relevant Alternative

As with schemes of arrangement, the evidence supporting the "relevant alternative" if a Plan were not sanctioned is imperative. This is particularly crucial where the court might be asked to exercise it discretion to cram down the Plan, because the court will need to be satisfied that any dissenting creditor is "no worse off" than the relevant alternative. Frequently, the courts have had to consider whether information presented in the Plan is sufficient to enable creditors and members to make an informed decision about whether to vote in favour of the Plan or not. As noted, the level of detail will depend on, among other things, the nature and complexity of the Plan.

In order to support the argument that an insolvency process was the most likely relevant alternative, companies such as *Gategroup* and *Virgin Atlantic* provided liquidity information to demonstrate that the company would likely run out of cash within weeks of the Sanction Hearing without an approved Plan.

One way to address a potential challenge to the "relevant alternative" is to consider whether to propose different alternatives. For example, in both *Premier Oil* and *Pizza Express*, where liquidation was the most likely relevant alternative, other alternative scenarios were also presented to substantiate the claim that liquidation was the most likely in the circumstances.

There is an expectation that dissenting creditors should submit their own competing valuations if and where necessary, although the court confirmed in *GAS* that creditors were not obliged to do so as many thought was the case following *Smile Telecoms*. Whether or not expert evidence is required, much depends on the facts – but the fact that a creditor does not produce expert evidence in reply will not preclude it from questioning the evidence provided by the company. Where, as in *GAS*, the outcome for creditors (particularly HMRC) was marginal, the expert evidence provided by the company was critical to support that creditors would be better off under the Plan. The court, however, found that the evidence was not robust enough to support that finding.

Restructuring Surplus

It is important to note that a Plan is not subject to the usual statutory order of priorities. Payments and how creditors are treated under the Plan do not have to reflect the position in the relevant alternative – which has been a particular concern for HMRC, who hold secondary preferential status in alternative insolvency processes. HMRC tried to elevate their position in the recent *Prezzo* case to a '*critical creditor'* however the court was not prepared to say that payment of tax that accrues whilst a plan is being proposed should be treated as a critical in all cases.

The question of how any value or potential future benefits post restructuring – often referred to as the "restructuring surplus" – is divided among creditors is a key consideration, particularly when it comes to whether the court will exercise its power to cram down. The court will be concerned whether the surplus has been fairly distributed. If creditors are treated differently, the Plan company needs to justify why they have been.

Virgin Active was one of the first fully opposed Plans and the first to compromise multiple classes of landlords. This has recently been followed in *Fitness First* where the landlords strongly opposed the Plan. One of the takeaways from the *Virgin Active* case was that it is generally for those creditors who are "in the money" to determine how to divide up the "restructuring surplus". Since the dissenting lower ranking classes would be out of the money in the relevant alternative to the Plan, the court attached little weight to the opposition to the Plan in those classes or to opposing landlord objections as to what the secured creditors had agreed with the companies.

More recently, where HMRC has taken an active role in opposing Plans, asserting (among other things) that the distribution of the restructuring surplus is unfair because it doesn't reflect its status as secondary preferential creditor there has been a sharp focus on whether the restructuring surplus has been fairly distributed. Fairness is and will be a key consideration for the court when it is being asked to cram down. In *Prezzo* the Court considered it was fair in the circumstances and the Plan was sanctioned and HMRC crammed down. HMRC was also a creditor under the recent *Fitness First* Plan but supported the Plan, no doubt because it will be repaid in full.

Costs

As with any new process, the unknown, the complexity and the duration, together with the two mandatory court hearings and the risk of challenge from dissenting creditors, can make a Plan a lengthy and expensive process. However, as mentioned earlier, it is hoped that, as the Plan becomes more familiar and the number of sanctioned Plans increase, it will become more accessible to (smaller) companies, as the costs of proposing a Plan should decrease.

The Future

In light of the above to bring costs down and make the Plan a more accessible tool for all companies, professionals and the UK Insolvency Service (in its final evaluation report on the UK Corporate Insolvency and Governance Act 2020) have suggested a number of possible reforms, including:

- Dealing with simple Plans at a single Sanction Hearing
- Dealing with the Convening Hearing on paper, reducing the time and cost of two physical court hearings
- Issuing a standardised form or template Plan to reduce costs
- Reforming legislation to provide expressly that Plans have extra-territorial effect to reduce costs and create more certainty

Also it would be helpful to have guidance from HMRC about what it expects from a Plan, so that HMRC can be on board from an early stage to prevent the time, costs and risks of challenge.

Companies need to tread carefully if they are carrying a large HMRC liability that needs to be restructured. It appeared after *GAS* that it might become necessary in the future to reflect HMRC's status as secondary preferential creditor in the division of any restructuring surplus, however following *Prezzo* this seems unlikely without legislative change. In summary the approach for companies should continue to be that HMRC is a key stakeholder (albeit not always critical) whose position companies will need to consider carefully. However the *Prezzo* sanction has shown that all is still to play for.

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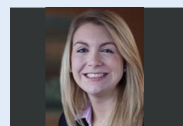

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