One year of the profession's new power tool: restructuring plans

David Mohyuddin QC and **Andrew Brown** review the judgments made on restructuring plans to identify common themes in their usage.

For many, the past year has provided a sense of suspended animation as the various lockdowns have slowed change and opportunity. The same cannot be said for the field of corporate insolvency and restructuring, which has seen the genesis of the new 'restructuring tool' introduced in June last year by the Corporate Insolvency and Governance Act 2020 (CIGA). Billed as a sort of 'UK version' of US Chapter 11 corporate bankruptcy, the tool allows for a court-sanctioned restructuring within which a company might be able to 'cross-class cram down' dissenting classes of creditors and bind them to a compromise when it is facing financial difficulties, and propose an alternative that would provide a better result for creditors. This provides an alternative to the existing English schemes of arrangement, which do not allow such cram downs.

Initially billed as an opportunity for larger corporates to restructure their liabilities in the face of financial difficulties, it was not known how the tool would ultimately be used – and whether it would filter its way down to SMEs. The past year has seen a small but steady stream of plans and their associated judgments, which has provided some guidance for those seeking to use the tool in the future. Rather than a mere rehashing of how the tool might be used, this article attempts to review the themes that can be drawn from those matters that have been the subject of judgments.

Class composition

The headline change brought about by the new tool is the potential for a cram down. This focuses the mind on the issue of how a company proposing to use a plan organises its creditors into classes. CIGA does not give direct guidance on how classes might be composed and it was assumed that the approach to schemes of arrangement might be adopted. In schemes, the court determines whether the legal rights to be released or varied under the scheme or the new rights to be given under the scheme are so distinct that the scheme has to be treated as a compromise or arrangement with more than one class of creditor or member, as appropriate. If any such rights are so dissimilar as to make it impossible for the relevant creditors to consult together with a view to their common interest, then separate class meetings should be convened.

The first case relating to the tool and class composition was considered by Trower J in *Virgin Atlantic Airways Ltd* [2020] EWHC 2191 (Ch). In that case, four classes of creditors were proposed:

(i) lenders under a secured credit facility;
(ii) lessors of 24 aircraft;
(iii) connected parties who were creditors under agreements; and
(iv) certain unsecured trade creditors.

There were no contentious submissions on this point and the judge applied the criteria to class composition regarding schemes of arrangement as set out above.

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Sir Alistair Norris QC took the same approach to class composition in *Pizza Express Financing 2 Plc* [2020] EWHC 2873 (Ch), which split the interested parties into three classes: a plan member company holding all of the company's shares, holders of senior secured loan notes and holders of senior unsecured loan notes. The reasoning was straightforward as the plan member was merely a shareholder, and the unsecured note holders subordinated the secured note holders, so were fundamentally different in their legal rights.

In *Gategroup Guarantee Ltd* [2021] EWHC 304 (Ch), the court was unwilling to sanction the initially proposed class composition of having only one class for senior lenders and bondholders. It considered this inappropriate and required different class meetings. In this regard, Zacaroli J drew upon *Virgin* and its application of the rules from schemes of arrangement regarding whether the rights of the proposed groups are so dissimilar as to make it impossible for communal consultation.

What remains to be seen is the court's approach where the proposed class composition is controversial. Previously, schemes of arrangement have as few classes as possible in order to prevent a creditor or a class of creditors holding a veto – essentially to water down each creditor's vote within the group. When seeking to use a plan, the opposite might be true as it is more likely to be to the company's advantage to have more classes as the cram down provisions can apply if even one of these classes approve the plan. This potential manipulation is well known in US Chapter 11 bankruptcies (known as gerrymandering), and, in *Virgin*, Trower J was aware of the possibility but was ultimately satisfied with the class composition.

The foreign element

In keeping with the international flavour of today's world, CIGA allows the tool to be used on foreign companies as well as domestic. Under s901A(4) of the Companies Act 2006, a 'company' is defined as one that is liable to be wound up under the Insolvency Act 1986. That will obviously apply to companies incorporated in this jurisdiction, such as was the case in *Virgin*. However, it will also apply to overseas companies, where the court will adopt the same approach used in schemes, namely whether the company has a sufficient connection to the jurisdiction, such as assets or trade here (*Re Noble* [2018] EWHC 2911).

This potential application to foreign companies was first put to the test by Trower J, making his second appearance in this article, in *Smile Telecoms Holdings Ltd* [2021] EWHC 685 (Ch), which concerned a Mauritian incorporated holding company of an African telecoms business. At the sanctioning hearing, the judge was satisfied of a sufficient connection as the company's liabilities to plan creditors were nearly all governed by English law with English jurisdiction clauses, and the company had shifted its COMI to England in June 2020 by moving its administrative offices to London, registering with Companies House as a foreign establishment and maintaining an English bank account. The final sanctioning of the plan was adjourned at the last reported hearing in March to consider other elements of the plan, but the issue of jurisdiction was resolved positively.

A related issue arose in *Gategroup*, wherein Zacaroli J had to consider the applicability of the Lugano Convention (Lugano) to plans, which would have potential significant impact on future cross-border insolvency work. Lugano allows cross-border enforcement of judgments between member countries, which otherwise would need to be dealt with by various domestic regulations depending on the particular state. Post-Brexit, the UK has not yet joined the Lugano Convention. While recent indications from the European Commission have poured some cold water on expectations, the hope is still that the UK will be able to join in the future. However, Lugano and the Hague Convention specifically carve out insolvency proceedings as being outside their ambit, so the decision in *Gategroup* would have an impact on potential future applicability of cross-border restructuring plans. Previously, schemes of arrangement have been held *not* to be insolvency proceedings, so would be enforceable under Lugano (*Re Magyar Telecom BV* [2014] BCC 448). Following an analysis of the law, Zacaroli J ultimately held that plans were 'insolvency' proceedings primarily because the threshold condition for using the tool was that the company was in financial difficulties, which distinguished it from schemes. Further, a plan is a collective action overseen and sanctioned by the court, which is a reflection of insolvency proceedings.

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In *Gategroup*, the disapplication of Lugano was ultimately beneficial to the company as it meant the English court had jurisdiction to consider the underlying issue of Swiss jurisdiction bonds, but this might cut against future cross-border plans. Companies considering issues of enforcement across borders will have to think carefully about the potential applicability of any judgment sanctioning a plan in the UK to the individual foreign jurisdiction, and if the UK does join Lugano then a scheme of arrangement might be more attractive as it could be enforceable under the convention rather than having to consider individual nation recognition.

Court's discretion over dissent

Despite the cram down being the element of the tool that received the greatest press at the time of its inception, there has been limited use of this aspect. In fact, only one judgment, another from Trower J (making a third appearance) in *DeepOcean 1 UK Ltd* [2021] EWHC 138 (Ch), has had to consider the approach of the court when deciding whether to exercise its discretion in approving a cram down. In this case, three subsidiary companies in the DeepOcean group sought to use the tool to restructure their debts in a solvent wind-down, which would ostensibly give each creditor a better return than they otherwise would have received in an insolvency. Two of the three companies achieved the 75% approval from each class of creditors as required by s901F Companies Act 2006, but one of the companies had only a 64.6% approval from the non-secured creditor class, which meant the court had to consider whether it would exercise its discretion if the dissenting creditors would not be worse off than in the relevant alternative. The judge ultimately approved the plan, and relied upon the following: a company will have a 'fair wind' behind it where it has satisfied the court that no members of a dissenting class would be worse off than in the alternative and the plan had been approved by a class who would receive payment; the preponderance of approval by other creditors of the three companies was influential; a 'horizontal analysis' (such as those used in CVA challenges) indicated that while the treatment of secured and unsecured creditors was different, it was justified due to the nature of the debts; and, finally, the court had no issues with the mechanism of how the plan would operate.

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While *DeepOcean* certainly provides some guidance moving forward, it is somewhat exceptional on its facts, which sit outside the intended use of the tool for corporate rescue. The companies in question were never intending rescue as going concerns, so the court did not have to consider the structure of reorganisation (and what some creditors might lose) against the successful survival of the companies. Likewise, the use of the 'horizontal comparison' was easily done as there were simply two classes of creditors to consider: secured and unsecured. The picture becomes blurry where there might be a multiplicity of unsecured or secured creditors in different classes with different levels of approval, and the court might have to balance interests from similar but distinct classes of creditors.

SMEs – the next wave?

So far, the cases involving uses of the tool have been relatively limited in number, and largely concerned with large companies (often involving international elements). It remains to be seen whether there will be any attraction to SMEs in using the tool, and the next edition of *RECOVERY* will consider this very question. However, in the view of these authors, the tool provides a useful and accessible way of restructuring companies that are in financial difficulty. The statutory provisions are no less applicable to SMEs than they are to large corporates. □

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