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An Update on the Restructuring Tool - More than a Year On

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Overview:

Recent cases have highlighted the increasing use of the restructuring tool within different contexts, and some of the new challenges that were mere hypotheticals when the Tool was first introduced are now being tested by the Courts.

This update will examine the most recent and interesting cases.

PLAN OF ACTION:

1) Brief Overview of the Restructuring Tool
    - Basics of Tool;
    - Procedure;
2) Issues of Class Composition and Gerrymandering
3) Explanatory Statements to Creditors
4) The Financial Test
5) A compromise?
6) The Foreign Element – whether the Tool will apply to the company
7) The Court's discretion to sanction – dissent from a class of creditors

Overview of the Tool: Basics

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- **Similar to Schemes of Arrangement, the Tool is a means of reorganising the liabilities of a company in financial distress by way of a compromise or arrangement with its creditors.**

- **Brought in by Corporate Insolvency Governance Act 2020 ('CIGA'), and added as Part 26A of the Companies Act immediately after Part 26, which deals with schemes of arrangement. Heavily influenced by Chapter 11 bankruptcies in the USA, it allows for a 'cross-class cram-down' of dissenting creditors.**

- **A company falls within Part 26A if it is liable to be wound up under the Insolvency Act 1986 or the Insolvency (Northern Ireland) Order 1989 (section 901A(4)(b)):**
  - Companies incorporated in England and Wales;
  - Overseas companies with a sufficient connection to this jurisdiction, provided that the plan will be effective in practice (See: *Re Noble* [2018] EWHC 2911 (a case on schemes).

Overview of the Tool: Procedure

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- **Originating Application supported by evidence addressing any issues which may arise:**
  - as to the constitution of meetings of members or creditors;
  - as to the existence of the court's jurisdiction to sanction the plan;
  - As to any issues relevant to the conditions to be satisfied;
  - any other issue not going to the merits or fairness of the plan, but which might lead the court to refuse to sanction it.

- **Two hearings with a meeting of creditors sandwiched in the middle.**
  - The first hearing: the convening hearing, deals with:
    - Issues related to class composition
    - Notice given to creditors
    - Financial Test
    - Whether a compromise
  - The second hearing: the sanction hearing, deals with:
    - Whether to sanction in light of the result of class meetings
    - Statutory requirements complied with? Fair representation at meetings? Cram-down appropriate? Reasonable person approve? Any blots or defects?

Overview of the Tool: Issues?

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- Class Composition and gerrymandering
- Notice to Creditors
- Financial Test
- A compromise?
- Foreign Elements
- Sanctioning issues: Cram-down

Class Composition

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- In Schemes the approach is as few classes as possible as any one class can veto the scheme.
- Cross-class cramdown attempts to avoid this – one class can sanction the plan despite dissent from another. If 75% in value of a class vote to sanction the plan, then accepted by that class. Potential benefit in having more and smaller classes?
- A cram-down cannot put the dissenting class in a worse position than they would be in the relevant alternative.

- *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2191 Trower J
  - The court was to take broadly the same approach to class constitution as was required under Schemes. A class had to be confined to those persons whose legal rights were not so dissimilar as to make it impossible for them to consult together with a view to their common interest. The question of whether consultation was possible depended largely on whether there was more to unite the relevant creditors than to divide them.
  - Four classes suggested and approved: lenders under secured facility, lessors of 24-aircraft, connected creditors, unsecured trade creditors.

- *Pizza Express Financing 2 Plc* [2020] EWHC 2873 (Ch) Alistair Norris QC
  - 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 were subordinated the secured note holders, so fundamentally different in their legal rights.

Class Composition

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- *Gategroup Guarantee Ltd* [2021] EWHC 304 (Ch) Zacaroli J
  - the Court was unwilling to sanction the initially proposed class composition of having only one class for senior lenders (under an English law lending facility) and bondholders (having been issued by Luxembourg subsidiary and subject to Swiss law).
  - It considered this inappropriate and required different class meetings as the rights of the senior lenders and bondholders both before and after the plan were different.

- *Re Amicus Finance PLC* [2021] EWHC 2255 (Ch) Snowden J
  - The company had provided short-term property finance with the majority of its loans funded through a trust structure.
  - Initially proposed one class for the security trustee of 418 lenders and separate creditor.
  - Judge refused to allow that as the two creditors were similar to a point, but diverged once security trustee was paid as separate creditor was then a junior creditor.
  - Two classes. Both creditors in the first up to the value of the security trustee's debt, then the separate creditor solely.
  - Focus should be on rights of creditor rather than its identity

Notice to Creditors

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- Before voting, an explanatory statement of the Plan must be sent to the various groups of creditors.
  - In Schemes these notices are long and complex, and not suitable for SMEs.
  - The Practice Statement stipulates that the notice must be in a form appropriate to the circumstances of the case and as concise as the circumstances permit: opens the door to SMEs?

- *Re Sunbird Business Services Ltd* [2020] EWHC 2493 (Ch) [Scheme of Arrangement] Snowden J
  - The company proposed a scheme of arrangement to offer company shares to the creditors in proportion to the value of the debt they held. The scheme was also conditional on the company raising cash through a rights issue of 15 million shares which would offer the creditors the option to purchase further shares
  - Explanatory statement did not provide information as the company directors' material interest
  - While asserted scheme better than insolvency for creditors, provided no specific information for creditor evaluation nor independent advice
  - Paucity of information led to scheme being dismissed

- *Re Amicus Finance PLC* [2021] EWHC 2255 (Ch) Snowden J
  - *It is not the function of the Court at the convening stage to review the contents of the Explanatory Statement line-by-line, nor to verify the accuracy of its contents, I am satisfied […] that, prima facie , <u>there is sufficient information to enable creditors to take a view on the merits of the proposed Restructuring Plan</u>. But that does not, of course, prevent a creditor who takes a different view arguing to the contrary at sanction.*

Financial Test

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- The company must have encountered or be likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern (section 901A(2))
  - lots of indeterminate and elastic terms: 'must have', 'be likely', 'are affecting', 'will affect', 'may affect.' What does Likely mean? What about 'may'? Contingent Debts?
  - No significant disputes on this test has yet resulted in scheme being denied at first hearing.

- *Re Amicus Finance PLC* [2021] EWHC 2255 (Ch) Snowden J
  - Already in administration. The cashflow forecast prepared by the administrators showed that the company was expected to operate at a loss for the foreseeable future due to the low amount of income generated by its loan portfolio as against a high level of outgoings.

- *Re Hurricane Energy Plc* [2021] EWHC 1759 (Ch) Zacaroli J
  - In 2017 the company raised US $230 million via the issue of convertible bonds in order to embark on extracting oil. The maturity date for the bonds was July 2022. It discovered that its oil wells had significantly fewer reserves of oil than previously estimated.
  - The evidence adduced by the Company included a report by PwC containing a detailed analysis of the financial position of the Company, and the relevant alternatives such as liquidation.
  - *"The threshold for Condition A is, however, relatively low. It is enough that the Company is likely to encounter financial difficulties that may affect its ability to carry on business as a going concern. I am satisfied on the basis of the extensive review undertaken by PwC that this threshold is met."*

Foreign Elements – Is the Company within the jurisdiction? 1

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- **A company falls within Part 26A if it is liable to be wound up under the Insolvency Act 1986 or the Insolvency (Northern Ireland) Order 1989 (section 901A(4)(b)):**
  - Companies incorporated in England and Wales;
  - Overseas companies with a sufficient connection to this jurisdiction, provided that the plan will be effective in practice (See: *Re Noble* [2018] EWHC 2911 (a case on schemes).

- **Gategroup Guarantee ltd [2021] EWHC 304 (Ch)**
  - Zacaroli J had to consider the applicability of the Lugano Convention ('Lugano') to plans involving the Tool. Lugano specifically carves-out insolvency proceedings as being outside their ambit.
  - Previously, schemes of arrangement have been held to *not* be insolvency proceedings, so would be enforceable under Lugano (*Re Magyar Telecom BV* [2014] BCC 448).
  - Zacaroli J ultimately held that plans were 'insolvency' proceedings primarily because the threshold condition, which distinguished it from schemes.

Foreign Elements – Is the Company within the jurisdiction? 2

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- **Smile Telecoms Holdings Ltd [2021] EWHC 685 (Ch)**
  - 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 Court's Sanction

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- The Court maintains the discretion at the final hearing to determine whether to sanction the proposed plan or not.

- Most likely challenge is against cross-class cramdowns, likely to be raised by aggrieved crammed creditors.
  - Condition A: The court must be satisfied that none of the members of the dissenting class would be any worse off than they would be in the event of 'the relevant alternative.' The 'relevant alternative' is whatever the court considers would be most likely to occur in relation to the company if the restructuring plan were not sanctioned.
    - i) identifying what would be most likely to happen to the company if the plan were not sanctioned (Step 1);
    - ii) determining what the consequences would be for shareholders (Step 2); and
    - iii) comparing that outcome with the likely outcome and consequences for shareholders were the plan sanctioned (Step 3).
  - **Condition B**: The restructuring plan must have been approved by 75% in value of at least one class of creditors or members who would receive payment or have a genuine economic interest in the company in the event of the 'relevant alternative'.

The Court's Sanction

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- *Hurricane Energy Plc* [2021] EWHC 1759 - refusal to sanction
  - Under the plan, the maturity date of the bonds would be extended to December 2024, and the capital amount due would be reduced to US $50m (from $230m) .

  - The company would issue shares to the bondholders, with the result that the bondholders would hold 95% of the diluted equity, with the existing shareholders retaining only 5%. The company would then undertake a wind-down and liquidation.

  - The plan was opposed by 90% of shareholders, but approved by 100% of bondholders.
    - Step 1: No imminent threat of insolvent liquidation;
    - Step 2: Point in contention.
    - Step 3: No likely return to shareholders if plan sanctioned;

  - Analysis of Step 2: There was a realistic prospect that the Company would be able to meet its payment obligations to the bondholders, while leaving assets with potential for exploitation. That was enough to refute any contention that the shareholders would be no better off under the relevant alternative. To retain 100% of the equity in a trading company, with a realistic prospect of being able to repay the bonds in due course, was a better position than giving up 95% of the equity.

The Court's Sanction

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- *Virgin Active Holdings Limited & Others* [2021] EWHC 1246 (Ch)
  - First fully opposed sanction of a plan
  - Seven classes of creditors*:* Secured creditors; Existing landlords, split into five classes; and General property creditors.
  - Secured creditors and Class A landlords approved. Four landlord classes and general creditors disputed.
  - *Condition A:*
    - the most likely relevant alternative to Virgin Active's restructuring plans was an administration involving the accelerated sale of the most valuable parts of the companies' businesses;
    - the valuations and calculations in the plan companies' evidence appeared to be reasonable and capable of being relied upon for the purposes of determining whether to sanction the plans. The landlords provided no competing evidence. Based on the evidence, each dissenting class of plan creditor would be no worse off under the plans than in the relevant alternative.

Virgin – Exercise of Discretion

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- *Virgin Active Holdings Limited & Others* [2021] EWHC 1246 (Ch)
  - Part 26A gives little guidance on the factors that are relevant when the court is exercising its discretion.
  - since the opposing landlords would be out of the money in the relevant alternative, the court attached little weight to the numerical opposition to the plans in the lower-ranking classes;
  - for the same reason, opposing landlords' objections to what the secured creditors had agreed as to the share of the "restructuring surplus carried no weight;
  - instead, it is for those creditors who are "in the money" to determine how to divide up any value or potential future benefits that use of the business and assets might generate post-restructuring;
  - the differential treatment between landlord classes was explained by reference to the profitability and commercial importance that the plan companies attached to the relevant clubs;
  - there was nothing inappropriate in choosing to use a restructuring plan rather than a CVA (where a CVA was likely to be blocked by the landlords' votes);
  - the retention of equity by the shareholders was predicated on substantial "new value" offered by the shareholder, where the court accepted that the new money lent by the shareholders could not have been obtained on the same or better terms from any other source in the market.

ANY QUESTIONS?

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Nope, cool.

Onwards to Lauren's talk