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The New UK Restructuring Plan: an overview

What is it?

The UK Corporate Insolvency and Governance Act 2020 came into force on 26 June 2020. It introduced a new restructuring plan procedure amongst its package of permanent measures. The restructuring plan gives directors another tool when considering restructuring options. Directors faced with financial distress can now weigh up the new restructuring plan, or the existing "tried and tested" scheme of arrangement.

At first blush the two processes are very similar. Like the scheme, the restructuring plan sits in the Companies Act 2006 rather than the Insolvency Act 1986. Both processes require members and creditors to be grouped into "classes" based on their rights. The classes then vote on whether to accept the proposed plan or scheme, and in each case final approval rests with the court. We expect that the developed jurisprudence around schemes of arrangement will be drawn upon by the courts in relation to the restructuring plan.

A key feature of the restructuring plan, which is a first in English law, is the ability to implement a cross-class cram-down. This is a concept borrowed from the U.S. Chapter 11 process and its absence from the existing scheme was perceived as a weakness of that process. Subject to certain conditions, the ability to invoke the cross-class cram-down test allows a company to apply to the court to approve a restructuring plan, even where there are dissenting classes of creditors or members that voted against the plan.

The restructuring plan has already been used by Virgin Atlantic as part of its broader recapitalisation plan of approximately £1.2 billion (although there was no need for the cross-class cram-down to be used as the plan was approved by all four classes of creditors).

Article highlights:

Process

The procedure largely reflects the existing process for the scheme and will require at least two court hearings.

- To commence the process, directors apply to court for approval to convene the meetings of the creditors and members. Creditors, shareholders and other parties are also able to propose restructuring plans, but like schemes of arrangement, we expect this will primarily be a company-led process due to the level of disclosure required.
- A first court hearing is held to decide whether to convene the meetings at which each class of creditor and member will vote.

  In deciding whether to approve the convening of the meetings the court will consider whether:

  - the company meets the eligibility criteria (see below);
  - the classes have been formulated correctly;
  - any creditors or members should be excluded from voting on the basis that they have no genuine economic interest in the outcome; and
  - finally, whether the court itself has jurisdiction to consider the plan.
- If the court consents to the meetings being convened then notice of each meeting must be sent to the relevant members and creditors, together with a document outlining the restructuring plan and its effects (similar to the "explanatory statement" circulated for schemes).
- The meetings are convened for the members and creditors to vote and the votes are recorded. If the required thresholds are met, a second court hearing will take place. If none of the classes meet the required voting thresholds, then the process comes to an end.
- At the second court hearing the court will decide whether to sanction the plan. Like the scheme process, the court will not simply "rubber stamp" its approval and has an absolute discretion on whether to approve the plan.

If the plan is sanctioned but the company later enters into another insolvency proceeding, creditors and shareholders will continue to be bound by the approved plan. For example, an unsecured creditor could only prove in the insolvent estate for the amount of their debt as compromised by the approved restructuring plan rather than the amount of their original debt.

Eligibility criteria

The company must have:

- encountered, or be likely to encounter, financial difficulties affecting its ability to carry on business as a going concern; and
- the purpose of the plan proposed must be to eliminate, reduce, prevent or mitigate the effect of those financial difficulties.

Any type of company can be eligible, providing it meets the above criteria. It is not necessary for the company to be insolvent to be eligible. The plan can also be used by both English and foreign companies, although in the case of the latter, the company must also have a sufficient connection with the UK. This requirement is also seen in other English law processes, such as the scheme of arrangement and the new standalone moratorium. For schemes, this requirement has been satisfied by, for example, the company's debt documents being governed by

English law or the company having an establishment in the UK. We expect that similar considerations will be relevant for the plan.

The Secretary of State can exclude some or all financial service providers (for example, companies defined as "authorised persons" in the Financial Services and Markets Act 2000), where the plan might compromise creditors who are also authorised to sell financial services.

Differences between the restructuring plan and the scheme of arrangement

While the new restructuring plan builds heavily upon the key features of the scheme of arrangement, there are some important differences:

- *Financial difficulties*: Like the scheme, the restructuring plan is intended to be a flexible procedure but it must be designed with the purpose of eliminating, reducing, preventing or mitigating the company's financial difficulties.
- *Voting thresholds*: For a restructuring plan to be approved, 75% in value of the creditors or voting members within each class (which have a genuine economic interest present) must approve the plan. The additional approval requirement in schemes that requires a majority in number to bless the arrangement is not required for a restructuring plan.
- *Cross-class cram down*: Probably the most notable feature of the restructuring plan is the introduction of a cross-class cram-down mechanism. This gives a company (with court approval) the ability to potentially impose the plan even on dissenting classes of creditors and members. The court can approve such a plan provided it is satisfied that:
  - if the plan is sanctioned, no members of the dissenting classes would be any worse off than they would be in the event of a relevant alternative; and
  - at least one class of creditors or members that would receive a payment or have a genuine economic interest in the company in the event of a relevant alternative has voted in favour of the plan.

If the above conditions are met, the cross-class cram-down tool can be imposed to bind dissenting classes of creditors.

The relevant alternative is defined as whatever the court considers would be most likely to occur in relation to the company if the compromise or arrangement were not sanctioned by the court. The court has a wide discretion to consider what the relevant alternative would be. Courts already make a somewhat similar assessment when considering whether to sanction a scheme in light of the "comparator" to the scheme, although to date they have not had to consider to a large extent the relative differences in treatment of difference classes, because in a scheme each class whose rights are being compromised is required to approve a scheme. The court may well have reference to existing case law on the comparator when considering the relevant alternative. The onus is likely to be on the company to establish that the plan would provide the best outcome for those with a genuine economic interest when compared to a relevant alternative. Questions and evidence around the possible realisations of creditors will be critical for the company and the court to consider.

In the recent Virgin Atlantic restructuring plan, there was evidence that the group's cash flow would drop to a critical level without a restructuring. This in-turn would entitle certain creditors to take enforcement action over the company's landing slots at Heathrow Airport, which would have a catastrophic impact on the business. Evidence prepared by a financial advisory firm was put forward which supported the debtor's view that creditors would be better off than in the relevant alternative of an administration.

- *Cross-class cram-up*: The restructuring plan could also facilitate a cross-class cram-up. This would theoretically allow a junior class of creditors who approved the plan to impose the plan on a dissenting class of senior creditors. The court would have to be satisfied that the senior classes would receive at least what they would have received in the case of a relevant alternative, and in practice, we expect that it may be challenging to demonstrate that providing senior creditors with a long-dated instrument (albeit with improved pricing) is the same as (or better) than the relevant alternative, which would typically see them being repaid in full at the time of the restructuring.

The restructuring plan does not include the concept of an "absolute priority" rule; a key principle which underpins the US Chapter 11 process and its cross-class cram-down mechanism. The "absolute priority" rule requires that, in a restructuring proposal that intends to have junior creditors retain or receive any value under the plan, that dissenting senior classes are paid in full or receive sufficient value for their claims. The inclusion of the "absolute priority" rule (or similar) was discussed during the consultation phase of the legislation, but was ultimately not included in the final form of the Act.

The Annexures to this note outline some factual scenarios in which the restructuring plan may be used in practice.

Cross-border application

Given that the plan is a Companies Act procedure, we expect similar rules will apply to those that apply to a scheme of arrangement when considering whether the plan would receive international recognition. Assuming existing scheme jurisprudence is followed, we would expect, in summary:

- *European Union* - recognition will be similar to the rules around schemes. Like schemes, recognition under the Recast EU Insolvency Regulation (EIR) would not be available as the restructuring plan procedure is not listed in Annexure A of the EIR save where implemented through a process that is listed in that Annexure. Depending on the outcome of Brexit negotiations, recognition could be sought through the Recast Judgments Regulation (though this is unlikely to be applicable post Brexit) or the provisions of the Rome 1 Regulation, Lugano Convention, bilateral treaties and/or private international law.
- *United States* - automatic recognition as a "foreign main proceeding" likely to be available if the company has its centre of main interests in the UK. The Virgin Atlantic restructuring plan was recently recognised as a foreign proceeding under Chapter 15 of the United States Bankruptcy Code by the United States Bankruptcy Court (Southern District of New York).
- *Other jurisdictions* - will need to be determined on a jurisdiction-by-jurisdiction basis and will turn, in part, on the extent to which the state has incorporated the UNCITRAL Model Law on Cross-Border Insolvency Proceedings into its laws, failing which the company will need to rely on private international law rules on recognition.

Interaction with moratorium

In theory, a stand-alone moratorium and a restructuring plan could be used simultaneously. However, in practice we do not expect this would be a common strategy. There are key carve-outs to the moratorium, notably that the moratorium cannot be used if the company is party to a capital market arrangement of at least £10m. Further even when a company uses the moratorium it is still required to meet its debts to financial creditors. There may be circumstances where the moratorium could be used for a short period to give the company relief from certain creditors and give it a "run-way" to prepare a wider restructuring by using the plan.

If there is already a moratorium in place in the 12 weeks before a restructuring plan is proposed then creditors in respect of debts for which the company has not had a payment holiday in the moratorium may not participate. This would need to be factored in by a company formulating a plan when gauging creditor support.

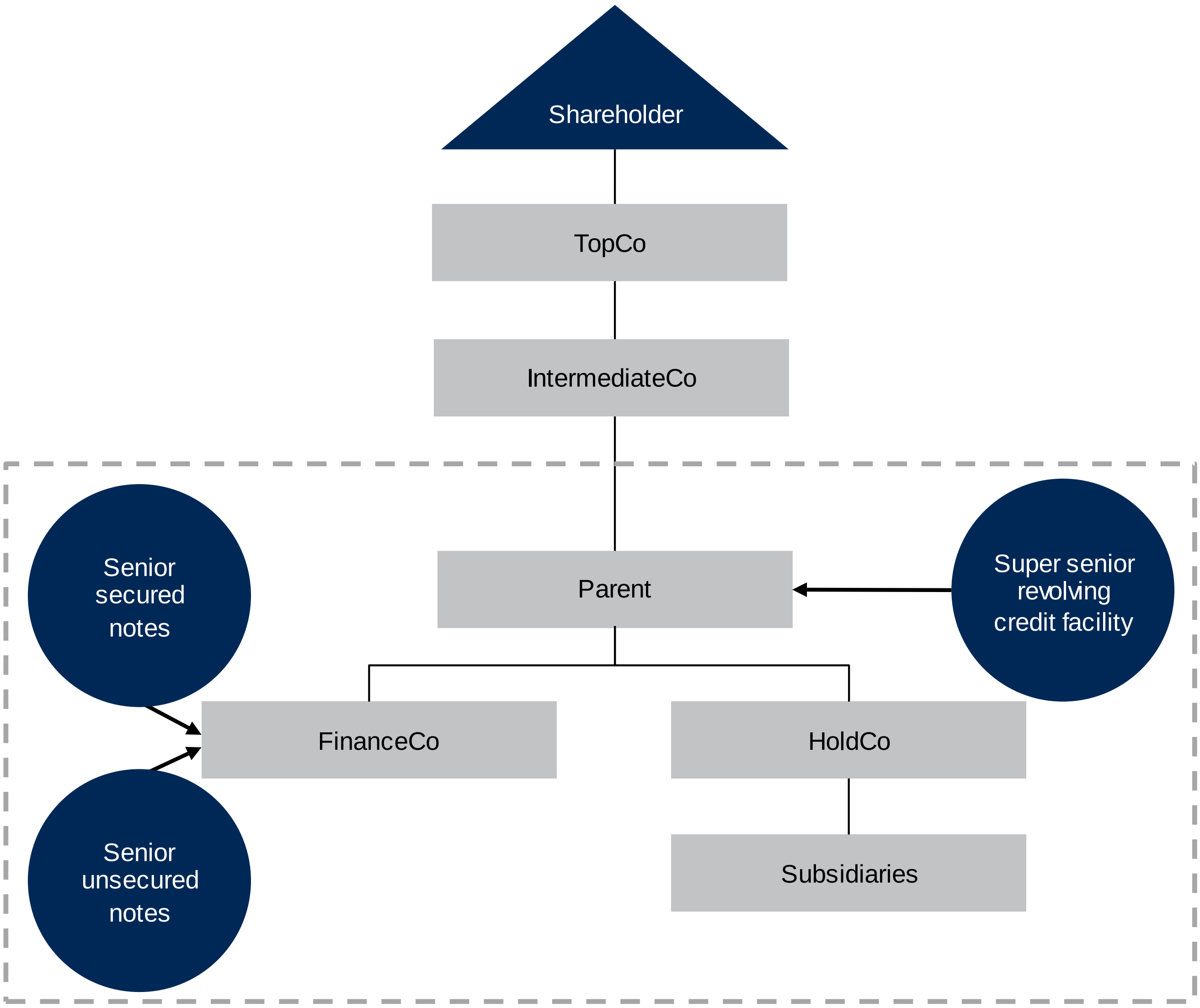
Comment

The restructuring plan and its cross-class cram-down feature is a welcome addition to the English law restructuring toolkit. We expect it to be attractive to companies undergoing large scale balance sheet restructurings when compared with the tried and tested US Chapter 11 process, or the new Dutch scheme.

Arguably, the absence of an "absolute-priority" rule gives the restructuring plan an added flexibility, which will be appealing for stakeholders considering their restructuring options. On the flip side, the requirement of a 75% approval threshold is higher than the two-thirds approval requirement in the US Chapter 11 process and the new Dutch scheme. Lower voting thresholds can be appealing, particularly in bond restructurings, where the level of support from creditors is not always easily ascertained at the outset. When assessing whether to use the new restructuring plan or the existing scheme of arrangement combined with a security enforcement or administration sale, if the required creditor support is forthcoming practitioners may want to stick with the tried and tested scheme of arrangement. If there is uncertainty about creditor support or a need to deal with creditors whose claims cannot for whatever reason be released contractually then the restructuring plan may be preferable in order to deploy the cross-class cram-down mechanism.

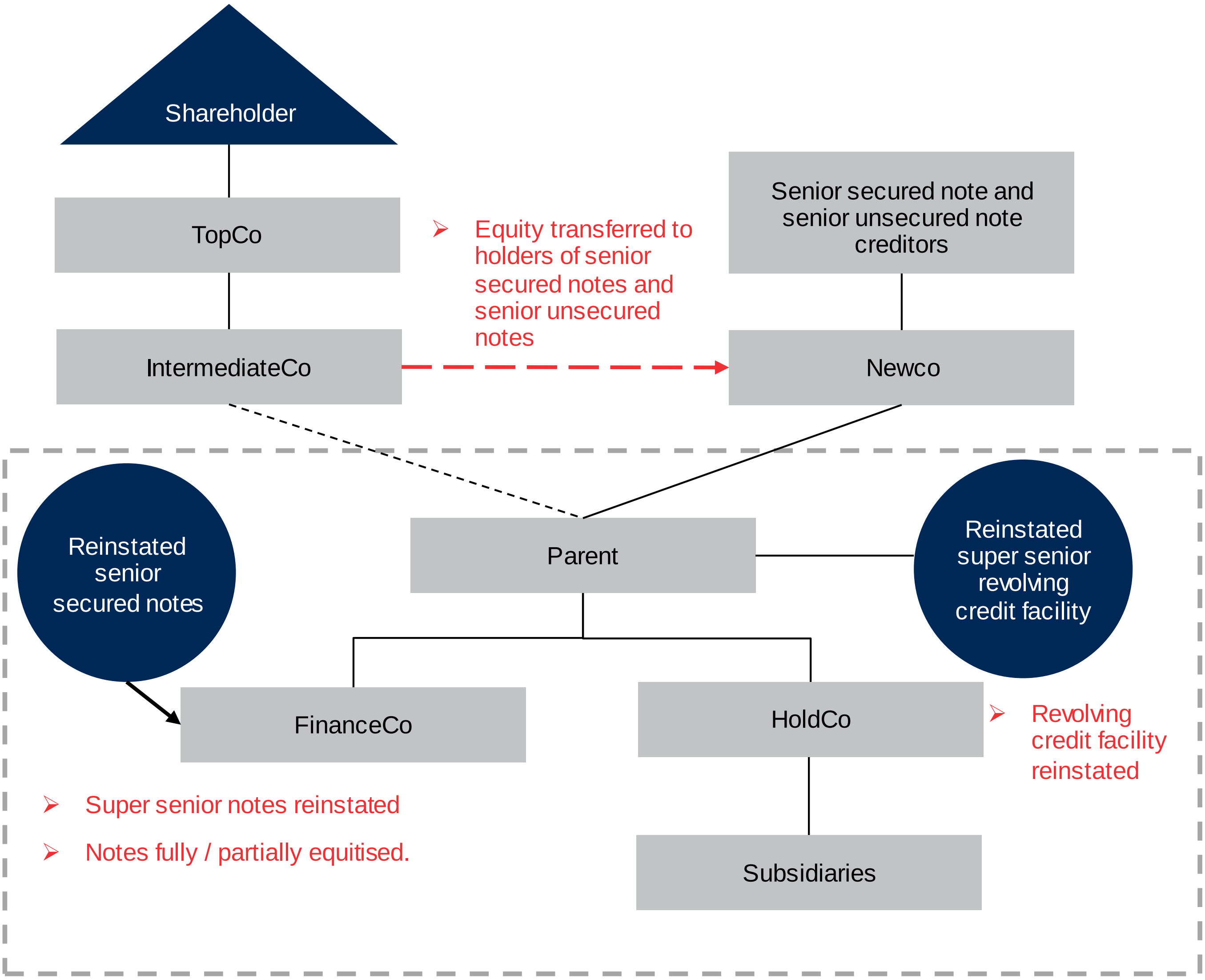
It will also be interesting to see how the relevant alternative test develops. The relevant alternative comparator is a crucial aspect of the cross-class cram-down mechanism. The Act does not prescribe examples of "comparators" (which could for example include the likelihood of insolvency or creditors taking enforcement action). There is thus considerable flexibility for debtors (and indeed aggrieved creditors) to frame the relevant alternative using valuation evidence. This was not tested in the Virgin Atlantic restructuring plan. The court is not obliged to sanction a plan simply because the required voting thresholds have been met. If the dissenting voters can convincingly argue, for instance, that their interests would be unfairly overlooked in the event of a cross-class cram-down, they may be able to influence the outcome. Courts in turn will have considerable discretion in developing the law in this area.

Annexure: Restructuring Plan - typical capital structure



- Four classes of creditors: revolving credit facility; senior secured notes; senior unsecured notes; and equity.
- Restructuring plan could be used to:
  - convert the senior unsecured notes to equity;
  - partially convert senior secured notes to equity and partial debt reinstatement; and
  - amend the revolving credit facility to extend term and improve pricing for lenders.

Annexure: Restructuring Plan - capital structure after implementation



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