The new UK Restructuring Plan

dlapiper.com/en/uk/insights/publications/2020/06/the-new-uk-restructuring-plan/

The recently introduced Corporate Insolvency and Governance Bill contains a range of significant reforms, not least of which is the introduction of a new Restructuring Plan process. Together with the sweeping changes that the Bill has in its sights, the Restructuring Plan and associated changes are aimed at improving the tools for companies to be effectively and efficiently rescued.

Key takeaways

This Article is part of DLA Piper’s series of publications on the Bill, and focuses on the Restructuring Plan in detail. The Restructuring Plan is a tool which has the potential to change the way many UK restructurings are implemented by moving the UK restructuring processes and procedures closer to a “Chapter 11 Lite” model.

Restructuring Plan Procedure

Arrangements and reconstructions for companies in financial difficulty

<table>
<thead>
<tr>
<th>New, stand-alone procedure</th>
<th>Modelled on successful UK scheme with enhanced provisions</th>
<th>New “cross-class cram-down” feature</th>
<th>Flexible with variety of outcomes permissible</th>
</tr>
</thead>
<tbody>
<tr>
<td>May be combined with new moratorium</td>
<td>“Overall commonality” will enable use of scheme case law</td>
<td>Bind both secured and unsecured creditors</td>
<td>Integrated alternative to CVA/Scheme</td>
</tr>
</tbody>
</table>

It is worth highlighting that at the time of writing this article the Bill is going through the typical parliamentary approval process, and the UK government has expressly provided for changes to the Restructuring Plan to be effected through secondary legislation, particularly in relation to the cross-class cram-down process. It is therefore possible that aspects of the legislation may change from what is detailed in this initial analysis.

What is it?

Drawing some inspiration from a Scheme of Arrangement under section 895 of the Companies Act 2006 (Scheme), the new Restructuring Plan is a powerful and flexible new court supervised restructuring process that will likely find favour for companies with a connection to the jurisdiction or English law governed credit agreements or contracts to
bind stakeholders to a rescue plan. Unlike a Scheme, the new Bill permits a Restructuring Plan to be imposed on a dissenting class of creditors, a so called “cross class cram down” which we evaluate in detail below.

Who proposes the Plan?

The Debtor/the Company – this is likely to be the case in most instances.

Creditors and Shareholders are able to make an application to court to commence the procedure although we suspect that the use by Creditors may be quite limited given the significant resourcing requirements that typically need Debtor/Shareholder input to put together a realistic and credible Restructuring Plan modelled on the existing business performance.

What are the qualifying conditions (if any) to the Restructuring Plan?

A Company which "has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern" may make an application to use the Restructuring Plan process. So in this respect it differs critically from a Scheme by introducing upfront a requirement that the business has or is likely to experience financial volatility and stress. To recap the Scheme is a Companies Act tool and is used for a number of different types of transaction regardless of the financial position of the Company (e.g. for takeovers).

What can a Restructuring Plan contain?

As long as there is some form of compromise or arrangement and the purpose of it is to deal with the company’s financial difficulties then this is virtually a blank canvas. We would expect, similar to the use of Schemes to see a variety of flexible business outcomes to support a business seeking to agree a restructuring with its creditors (for example amend-and-extend style schemes to modify credit agreements versus debt-for-equity style restructurings), and for there to be significant flexibility in the application of this new Restructuring Plan. There are a few areas, notably which touch the aviation sector (a sector which is and will continue to face material difficulty due to the COVID-19 pandemic), where the plan cannot compromise existing rights.

Does valuation play any part?

The Restructuring Plan enables the compromise of the debt and equity claims of creditors and/or shareholders which the court is satisfied have no genuine economic interest in the company. The consent of these persons with no genuine economic interest is not required and they have no right to participate in the Restructuring Plan approval process. This will put valuation at the heart of a courts judicial scrutiny of any Restructuring Plan. Whilst the court has wide discretion as to the assessment of economic interest, valuation evidence is likely to continue to play a significant role in guiding the court to analyse the position of “out of the money” creditors. This will be particularly acute where there are multiple classes proposed as part of the restructuring.
and the court is asked to approve a Restructuring Plan where significant classes have accepted the plan treatment but not others. We expect this to be a key area of challenge and/or litigation.

Introducing the “Cross-class cram-down” for the first time in the UK context

The new procedure could potentially limit the ability of “hold-out” or ransom creditors to block a viable restructuring proposal which has the overwhelming support of those creditors who retain an economic interest in the business. It also opens up the possibility of altering equity interests as part of a Restructuring Plan without the consent of the relevant shareholders.

Dissenting classes are able to be crammed down only if they would be no worse off than in 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. Again, this gives the court wide discretion as to the benchmark against which to assess the “no worse off” test. However, we anticipate that the starting point will be the appropriate comparator test that the courts use for assessing class composition in Schemes.

So shareholder rights can be amended by the Restructuring Plan?

Other than permitting a compromise or arrangement with members in order to deal with financial difficulties, the Bill does not deal expressly with the rights of shareholders. However, the intention underpinning the Bill is that shareholder equity can be transferred, diluted or extinguished as part of a court approved Restructuring Plan which makes sense in the context of distress where shareholder value is likely, in real terms, to be materially impaired, if not nil, based on the then subsisting valuation of the business. The Bill includes amendments to the Companies Act, including a disapplication of shareholder pre-emption rights, which appear to be intended to facilitate a dilution of shareholder rights pursuant to a Restructuring Plan. The ability to bind in shareholders can be a significant additional hurdle to achieve successful restructurings and these implicit powers are likely to be welcomed as part of the additional powers that companies will have under the Bill to promote corporate rescue and recovery through the delivery of a viable restructuring plan.

Is there court involvement?

The Restructuring Plan involves court oversight and approval and similar to the more establish Scheme process, there will be court involvement via two hearings. As the Bill is to be introduced as a corporate restructuring process not a formal insolvency process, the commencement of the process by a debtor to start a Restructuring Plan will not substitute the powers of the debtor/directors by the court and the process is largely similar to other debtor-in-possession processes like Chapter 11 of the US Bankruptcy Code.
What will be covered at the first hearing?

**Class composition:** Voting on the Restructuring Plan will be by reference to classes and the court will examine the proposed class composition at this first hearing. It is expected that the body of law and practice around class composition in the context of Schemes will be directly relevant.

**Information provided to creditors:** Provided it is satisfied with class composition, the court will then confirm that a vote on the proposals should take place on a specified date. We expect that creditors and those being asked to vote and participate in the Restructuring Plan will receive what will look very much like an explanatory statement used in the context of Schemes which would contain the details of the Restructuring Plan to enable them to assess its merits.

What thresholds or other rules apply to the voting?

**Voting Threshold**

The relevant threshold for approval is 75% in value (gross value of debt) of creditors in each class who vote. It is noteworthy that the anticipated requirement that more than half of the value of unconnected creditors vote in favour does not appear in the Bill. Similarly the numerosity test in Schemes (i.e. a majority in number voting in favour requirement which applies to Schemes) does not apply to the Restructuring Plan.

**Cross-class cram-down in more detail**

This is a new and powerful feature. Notwithstanding that a class does not vote in favour, creditors in that class may be bound by the plan if the cross-class cram-down rules are met. Those rules are:

1. at least one class of creditors “who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative” voted in favour of the Restructuring Plan;
2. the dissenting creditors would not be “any worse off” under that plan than they would have been in the event of “whatever the court considers would be most likely to occur in relation to the company” should the plan be rejected (which may not necessarily be the immediate liquidation of the debtor company, although this would probably be the correct comparator in many cases, given the eligibility criteria); and
3. the court is prepared to sanction the Restructuring Plan.

Court involvement is likely to be significant as regards rule (i) and rule (ii) with rule (iii) likely to be more of a catch all of fairness considerations generally drawing on the English court’s extensive experience of the same in the context of UK Schemes, until Restructuring Plan specific jurisprudence is further developed.

**Absolute priority rule missing**
The Bill does not contain any semblance of the absolute priority rule which was touted when the reforms were first announced in August 2018. It seems likely that in substance this becomes part of the test in step (iii) in so far as testing for consistency with the absolute priority principle is concerned and whether amounts owed to a dissenting class of creditors will be satisfied in full under the proposed plan before a more junior class could receive any distribution or keep any economic interest under the Restructuring Plan.

So what happens at the second hearing?

If the requisite voting thresholds are met and (if relevant) the rules for imposing a cross-class cram-down have been complied with, the court will decide whether or not to confirm the Restructuring Plan and make it binding on affected creditors and shareholders.

The court will, according to the explanatory notes accompanying the Bill, sanction the Restructuring Plan if it is just and equitable to do so. This is the same consideration that applies to Schemes at the equivalent second stage sanction hearing.

Simplified process

While all this is happening is there any protection from actions by creditors?

One of the notable disadvantages of the UK Scheme process and (absent a linked administration or (until the Bill is passed) small company eligibility) the UK CVA process is that those processes don’t automatically give the debtor a moratorium and breathing space during which to propose the process to its affected stakeholders.

The Restructuring Plan provides some much-needed flexibility and optionality here for companies that can take advantage of this breathing space. The proposal of a Restructuring Plan can be combined with the new moratorium procedure under the Bill.
which will prevent certain actions against the company while the Restructuring Plan is being progressed to approval.

Only time will tell how this will be used in practice, and some limitations to the effective use of this are likely to include the fact that such a moratorium is likely to be confined to the UK as a jurisdiction as opposed to having worldwide effect similar to the Chapter 11 moratorium. Proposing a Restructuring Plan is likely also to trigger an event of default under most LMA style loan agreements, and it will remain to be seen whether the moratorium would be effective to prevent the exercise of remedies by such creditors including as mentioned above where there is significant foreign collateral. An additional and likely significant limitation of the new moratorium procedure, as it currently appears in the Bill, is that all amounts falling due under financial contracts, including loan agreements, must continue to be paid during the moratorium. If the company is unable to pay such amounts the moratorium will end. Support from lenders, and potentially lock-up agreements, are still likely to be needed in many cases even where the moratorium is used. See our further analysis of the new moratorium.

Looking to the future where might a restructuring plan be used in the alternative to UK restructuring techniques we see now?

Comparison with other UK restructuring tools

Restructuring Plan as an alternative to Pre-pack Administration and Intercreditor Release Mechanic

Pre-pack administrations have become a key restructuring technique to deal with out of the money creditors in combination with the release of the claims of those out of the money creditors under LMA style intercreditor agreements. The following steps are typical:

- Step 1 - Administrators are appointed to a holdco;
- Step 2 - Holdco sells its subsidiaries to a Newco (consideration to Holdco can be structured by novating debt to Newco through a Scheme for example);
- Step 3 - The claims of “out of the money” junior creditors are released or sold by the security trustee pursuant to the distressed disposal provisions of an LMA style intercreditor agreement.

The Restructuring Plan enables a restructuring of both “out of the money” debt and equity to be implemented within the existing corporate structure without the need for a sale of the business and/or subsidiaries through a pre-pack administration. Intercreditors have been highly negotiated documents in leveraged financings particularly around releases and “safe harbour” provisions. As a result the pathway to enforcement is often more complex than a pure senior-junior wholesale subordination of economic and legal rights where senior controls the entire enforcement without fetter. We expect that the Restructuring Plan may provide alternative routes through intercreditor complications of this nature.

**Restructuring Plan as an alternative to a CVA**

**Secured and unsecured debts** - One of the key advantages of the Restructuring Plan over a CVA is the Restructuring Plan can compromise the claims of both secured and unsecured creditors. Therefore there may be some efficiencies by conducting the entirety of a restructuring through a Restructuring Plan rather than through a CVA with subsequent financial restructuring for example.

**Thresholds: no unconnected creditor test** - The Restructuring Plan, as set out above has a 75% approval threshold which is similar to a CVA however a key difference is that there is no express unconnected creditor approval threshold requirement, as there is in a CVA (a resolution to approve a CVA will be invalid if those voting against it include more than half of the total value of creditors unconnected to the company whose claims have been admitted for voting).

**Voting dilution** - As CVAs require all unsecured creditors to vote together as a single “class” they have been criticised (particularly by landlords in CVAs focussed on amending lease payment obligations (rent)) in circumstances where the difference between approval and rejection of the CVA might be the vote of unsecured creditors who, arguably, may not be being asked to compromise or alter their position as fundamentally as, say, landlord creditors. Conversely for companies this can be seen to be strategic advantage of a CVA.

Under the Restructuring Plan, where, for example compromise of landlord rights might constitute landlords in their own separate class for voting purposes, the cross-class cram-down procedure built into the Restructuring Plan does allow a restructuring to be imposed on a dissenting class of creditors. It is likely however that the same theory behind the vertical comparator test in a CVA will act as a check in the court’s sanction of the Restructuring Plan where the court is considering the “no worse off” test. Similarly
the relative fairness of the effect of the Restructuring Plan on any dissenting class of creditor by reference to the other classes, will likely include substantive checks similar to the CVA “horizontal comparator” test.⁶

Court involvement – a blessing or a curse?

Some may view the lack of court involvement in the CVA process as a significant benefit however the lack of court substantive scrutiny during the CVA process can lead to uncertainty at the back end of that process as to certainty with challenges on the basis of (i) some material irregularity at or in relation to the shareholders’ meeting or the creditors’ decision procedure, such as failure to supply the required information or (ii) that the CVA unfairly prejudices the interests of a creditor, member or contributory of the company, increasingly common.

The verdict on the new Restructuring Plan mechanisms

Reverse cram-down? (cram-up?)

A “cram-up” may be possible in theory where one or more classes of junior creditors and/or members approving the Restructuring Plan imposes a restructuring on one or more dissenting senior classes of creditors. There are some practical obstacles but if the court is satisfied that no dissenting class(es) would be worse off than in the relevant alternative and the class(es) approving the scheme would, in the relevant alternative, receive a payment or have a genuine economic interest in the company, the court will have jurisdiction to sanction the Restructuring Plan. Proving that a more senior class will be no worse off may be prove challenging in practice of course (e.g. is an extension of the term of lending (with the economics of income if that instrument goes to term) a no worse off position than repayment in full immediately where the value breaks below the senior debt?)

Valuation remains key to driving restructurings

The cross-class cramdown is likely to be a key area of litigation and/or challenge as is the court’s determination that a class of creditors does not have a genuine economic interest and therefore is disenfranchised and has no entitlement to vote in the Restructuring Plan.

Determining what is the appropriate relevant alternative and what value a creditor or shareholder would be likely to receive in the relevant alternative is also likely to be the subject of some debate between stakeholders.

Hold-outs?

It is worth noting that where the Restructuring Plan relates to debts which were covered by a moratorium which ended less than 12 weeks previously, the court may not sanction the plan if creditors with a “moratorium debt” or a “pre-moratorium debt” in respect of
which the company does not have a payment holiday are affected and have not agreed to it. See our analysis of the new moratorium for further information.

**Non-English companies and likelihood of Increased Forum Shopping**

The Restructuring Plan looks like it will be available to non-English companies as it retains the “sufficient connection” test in terms of jurisdiction which provides a relatively low bar of connectivity. Schemes of arrangement have been successfully applied to companies across the world, including in Germany, Spain, Bulgaria, France, Italy, the Netherlands, Ukraine, the US, Vietnam and Kuwait so long as it can be shown that the overseas company has sufficient connection with England for an English court to have jurisdiction over it.

Similar to a Scheme, a Restructuring Plan that compromises English law debt will be widely recognised in other jurisdictions following the Brexit transition period. This recognition is likely to be based either on private international law or other cross border frameworks.

These changes increasingly bring the UK’s “toolkit” for dealing with restructuring and insolvencies much closer to the US Chapter 11 framework (as can be seen from the comparison table below).

**The Restructuring Plan Compared**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Debtor in possession</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Stay on enforcement action</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Ban on ipso facto</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Separate classes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Cram-down</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Cross-class cram-down</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Support required</td>
<td>Not higher than 75% in amount or number of affected parties</td>
<td>75% by value and 50% by number</td>
<td>75% by value</td>
<td>2/3 in value</td>
<td>2/3 in value or majority in number of allowed claims in each class</td>
</tr>
<tr>
<td>Basis for founding jurisdiction</td>
<td>n/a</td>
<td>Sufficient connection</td>
<td>Sufficient connection</td>
<td>Public (CoMI); Private (sufficient connection)</td>
<td>Asset in the U.S.</td>
</tr>
<tr>
<td>Super-priority DIP finance</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Given the powerful provisions contained in the Bill for dealing with both secured and unsecured creditors, creditor cram-downs and cram-ups, and notwithstanding the introduction of far reaching insolvency and restructuring reforms in other jurisdictions, we suspect that given the experience of the English courts with CVAs and Schemes that the Restructuring Plan will prove popular for companies looking to promote and successfully implement a restructuring proposal.
There is no guidance as to whether a dissenting class has to be offered anything or specifically whether a Restructuring Plan can truly be called a “compromise” or “arrangement” without offering dissenting creditors something (even where they might get nothing on a liquidation).

The Bill does not state that this must be a class of impaired creditors (that is, creditors who will not receive payment in full under the Restructuring Plan) but in practice there is likely to be a very significant threshold set by the court to sanction a plan which might otherwise look like it is being “rail roaded” through by a class which is not taking any impairment under the terms of the Restructuring Plan. We expect that the “relevant alternative” will also be an area of focus, challenge and competing evidence as to what the relevant alternative should be.

An Insolvency event of default will typically include a sub-heading which states that an event of default shall occur if, “by reason of actual or anticipated financial difficulties, [the debtor] commences negotiations with one or more of its creditors with a view to rescheduling any of its indebtedness”.

Typically provisions which seek to impose certain objective measures (e.g. sale by a regulated insolvency officer, court supervised enforcement, a fairness opinion incorporating a valuation, a competitive sales process run by an independent investment bank etc) before permitting the release of claims.

The “vertical comparator” compares the projected outcome of the CVA with the projected outcome of a realistically available alternative process (usually liquidation). This sets a low water mark below which a CVA cannot go.

The “horizontal comparator” compares the treatment of creditors under the CVA as between each other. Whilst there is no prohibition on differential treatment, any differential treatment must be justified.