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Mid-market prospects for the restructuring plan

KEY POINTS

- There is clear scope for mid-market restructuring plans to become a cost-effective restructuring tool which will need to be considered alongside existing mid-market restructuring tools.
- An extensive body of restructuring plan case law has already developed which provides guidance on the restructuring plan's parameters and greater certainty for its implementation in the mid-market.
- Careful consideration needs to be given to the level of disclosure and timetable in a mid-market context.
- The restructuring plan is a debtor-friendly restructuring tool and further developments around the allocation of the restructuring surplus will be an important driver of the restructuring plan's position as a mid-market tool.

The Corporate Insolvency and Governance Act 2020 brought in to much fanfare the new restructuring plan (the 'RP'), a debtor-friendly restructuring tool to bolster the rescue culture in the UK. The RP was born of the much-vaunted scheme of arrangement (the 'Scheme'), a restructuring tool which has been on the statutory books in some form or other for over 150 years, but which had only really come to prominence as an effective restructuring tool following the global financial crisis in 2008.

The RP mirrors the Scheme but provides further firepower through its cross-class cram down mechanic and its ability to bind out-of-the-money stakeholders without them even voting. These features allow the RP to solve the problem of being able to restructure the secured and unsecured financial and operational liabilities of a debtor within its existing corporate form in a way that is not possible under either the Scheme, or the pre-packaged administration (the 'Pre-Pack') and company voluntary arrangement (the 'CVA') tools provided for under the Insolvency Act 1986.

The game-changing nature of the RP as compared to the Scheme is that it does not require approval from the requisite majority of every class of affected stakeholders; rather, just one class needs to approve and the other classes can be crammed down, subject to the relevant criteria being met. This significantly changes the negotiating dynamics, allowing for a debtor to more efficiently corral the necessary stakeholder support for restructuring solutions – as not only can an RP be imposed upon a minority group within a class but it can also be imposed upon a dissenting class as a whole.

Whether the RP will become an effective tool in the mid-market, and do the heavy lifting that has traditionally been achieved through the CVA and Pre-Pack, is still an open question. Initially, at least, there is no doubt that the RP has been challenging to deploy in the mid-market due to costs and timing constraints. Nevertheless, on its face, the greater efficiencies of being able to restructure secured and unsecured liabilities within the corporate entity are attractive. As a result, there is a growing momentum for distressed mid-market debtors to consider deploying this tool when the restructuring options analysis is run. Following the Scheme for Sunbird Business Services (Snowden J, *Re Sunbird Business Services Ltd* [2020] EWHC 3459 (Ch)) and the RP for Amicus (Norris J, *Re Amicus Finance Plc (In Administration)* [2021] EWHC 3036 (Ch)) there is also proof of concept around the mid-market deployment of the RP.

The key interlinked issues which will need greater clarity before the RP starts to be implemented as a go-to mid-market tool are execution certainty, costs and timings. Before we address these points, we briefly look at the potential advantages of the RP over the CVA and Pre-Pack which are currently the mid-market restructuring tools of choice.

ADVANTAGES OF THE RP OVER THE CVA AND PRE-PACK

The RP is a debtor-in-possession Companies Act 2006 tool. This provides substantial benefits as it does not have the insolvency stigma, with the potentially concomitant value destructive ramifications, that come with the CVA and Pre-Pack which are Insolvency Act tools.

The CVA, like the RP, does involve restructuring within the existing corporate entity; nevertheless, the ability to comprehensively restructure the debtor's liability profile is severely limited as the CVA can only restructure unsecured liabilities. Further, all unsecured creditors vote as a single class which may mean the necessary affirmative vote is unachievable in a CVA in circumstances where it could be achieved in an RP. Whilst the Pre-Pack does allow for secured debts to be restructured this can only be achieved by transferring the business out of the corporate entity. This tends to be value destructive, and in certain circumstances, such as for regulated businesses, it may be legally challenging or not feasible.

The RP provides for finality; following sanction, the debtor is able to move on and return to business as usual as there is very limited scope to challenge the RP. The RP process essentially front loads any dispute, as opposed to the CVA where there is a 28-day challenge period, with any challenge then being subject to the court timetable which can take over a year to resolve. Whilst the Pre-Pack involves an administrator potentially pursuing insolvency claims against third parties and the directors for a significant period of time following its implementation.

Feature

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Neither of these Insolvency Act tools involve the scrutiny of the court, unless a disgruntled stakeholder actively seeks to contest the restructuring. Court scrutiny is one of the RP's strengths, subject to cost and timing implications being managed appropriately. It provides stakeholders with better protection against the criticisms and resulting reputational issues that can arise due to lack of transparency in the process, especially where connected parties are involved in a Pre-Pack scenario.

This is by no means a comprehensive list of the advantages that the RP has over the Insolvency Act tools but it demonstrates that there is scope for the RP to have an active role in the mid-market should it be able to provide for the requisite level of execution certainty in a cost effective and expeditious manner.

KEY CHALLENGES TO BECOMING A MID-MARKET RESTRUCTURING TOOL

The RP is a short, concise section of statute, which sits on a broad body of case law derived from the Scheme, that provides significant guidance on the RP's parameters at this early stage. This Scheme case law has developed in small incremental steps over time and provides solid foundation stones for many aspects of the RP's parameters. It is important, however, to understand its limits as the cross-class cram down mechanism incentivises different behaviours and removes the safety net of creditor democracy. This requires the courts to delve deeper into issues of substantive rather than merely procedural fairness at the sanction hearing.

The RP has already been well tested, with numerous active stakeholder challenges at the convening hearing stage and a number which have followed through to challenge at the sanction stage as well. These challenges have produced significant guidance around the developing parameters of the RP which has reduced the initial execution and cost uncertainty around deploying this new tool. Whilst the RP remains the preserve of a select number of judges with specific expertise in restructuring, there should be a high degree of confidence that this crucial initial phase of its development will quickly lead to a defined set of clear parameters. This will greatly reduce execution risk and cost uncertainties as debtors better understand how far they are able to push the boundaries before their RP is likely to suffer the risk of cost exposure emanating from stakeholder challenges. Some of the key issues for the mid-market RP's prospects are looked at below.

Disclosure

Guidance around the RP process is set out in the updated June 2020 Practice Statement covering Schemes and RPs (*Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006)*), para 14 of which provides that the Explanatory Statement should be in a form and style appropriate to the circumstances of the case, including the nature of the member and/or creditor composition. It should be as concise as the circumstances admit. The commercial impact of the RP must be explained with such information as is reasonably necessary to enable creditors and/or members to make an informed decision as to whether or not the RP is in their interests and the courts recognise that *'perfection is not always attainable'* (Snowden J, *Re Sunbird Business Services Ltd* [94]).

The courts have made it clear that any additional disclosure sought must be *'in all the circumstances, proportionate'* (Zacaroli J, *Re Amicus Finance plc* [2021] EWHC 2245N (Ch) [15]). The urgency of the case, the extent to which the disclosure will assist in resolving issues that need to be determined at the sanction hearing, the burden on the company in terms of time and costs, and any delay in making an application for disclosure are factors which will be considered for disclosure applications.

In particular, the courts have been clear that RPs *'are intended to provide a solution for distressed companies meaning that first, this will often be against time pressure, and secondly, the company is likely to have limited resources'* (Zacaroli J, *Re Amicus Finance plc* [13]) to comply with any such disclosure order. The court will take into account the disclosure that has already been provided and *'the lack of time or funding to provide the sort of extended disclosure'* (Zacaroli J, *Re Amicus Finance plc)* [32]) requested by creditors or members. The Explanatory Statement need only include such information that plan creditors or members *'might reasonably require'* (Trower J, *Re DeepOcean 1 UK Ltd and others* [2021] EWHC 138 (Ch) [26]).

In summary, the court is wary of the voluminous disclosure in Schemes which may serve to obfuscate rather than clarify the key issues which stakeholders need to consider when determining how to exercise their vote. This provides fertile ground for practitioners to take a bold, cost-effective approach to RP disclosure and take the thinner disclosure that is provided for in CVA proposals, rather than the often very long and complex Scheme explanatory statements, as the starting point. As well as the CVA standard, practitioners should look to the standard provided for under SIP 16 regarding the level of disclosure that is expected of practitioners implementing Pre-Packs.

Classes

The approval of each class is required under the Scheme but not under the RP. This has provided an inherent drive for debtors proposing a Scheme to formulate broad classes so that the vote of minority dissenting stakeholders is diluted. This approach has been supported by the courts which have been keen to ensure that immaterial differences in rights held by minority groups should not fracture the class and thereby allow the minority to oppress the majority through what would otherwise be a holdout position if they were to be classed alone.

The initial expectation was that RP class formulation would be contested as debtors sought to propose narrower class formulations under the RP. To date this behaviour has not occurred, if anything, there has been an uptick in class challenges under the RP where challengers have sought to fracture the debtors proposed class formulation. Either way the importance of a class challenge is diminished under the RP in light of the cross-class cram down and less complex capital structures in the mid-market mean that class formation should generally be a more straightforward exercise for mid-market debtors.

Excluding out-of-the-money stakeholders

The ability to impose the RP on out-of-the-

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money stakeholders but exclude them from the vote under s 901(c)(4) is a powerful tool which was successfully deployed for the first time in the recent Smile Telecoms RP (Miles J, *Re Smile Telecoms Holdings Ltd* [2022] (12 January 2022) [76-84]). Debtors face a strategic decision as to whether to deploy this tool at the convening hearing and thereby address potential valuation disputes upfront or allow out-of-the-money stakeholders to vote and then rely on the cross-class cram down mechanic, thereby holding fire on addressing any resulting valuation disputes to the latter stage of sanction. This will be a heavily fact-dependent decision but the expectation is that the former approach is likely to become the market norm where the value break is clear. Resolving this key issue upfront in this manner provides significant benefits from a timing perspective and could allow the remaining part of the RP timetable to be curtailed.

Valuation disputes

The crux of the RP is the cross-class cram down mechanic, which involves ensuring that no affected stakeholder is worse off than they would be in the event that the restructuring were not to be implemented. This means identifying the most likely alternate scenario and comparing the return under the hypothetical alternate scenario with the proposed return under the restructuring scenario. Although this sets the stage for valuation disputes it is noteworthy that the courts have expressed significant concern, across numerous RP judgments, of being drawn into valuation disputes and have noted that the RP involves a careful balance of providing distressed debtors with the opportunity to restructure whilst ensuring that minority stakeholders are not oppressed.

It is noteworthy for the mid-market that the less expensive option of a 'desktop valuation' may be sufficient for establishing the relevant alternative and '*there is no absolute obligation to conduct a market testing process as part of a restructuring*' (Snowden J, *Re Virgin Active Holdings Ltd and others* [2021] EWHC 1246 (Ch) [139]). Whether to conduct a market testing process will be entirely dependent upon whether it is '*necessary or practicable in the circumstances*' (Snowden J [140]).

Allocation of restructuring surplus

Put simply the restructuring surplus is the value that is preserved as a result of implementing the restructuring rather than the relevant alternative insolvency scenario. The manner in which this restructuring surplus is allocated is a key point for stakeholders. The ability for equity to retain a stake or to provide for differential treatment of stakeholders with equivalent rights under the relevant alternative scenario is an evolving issue.

The RP statute does not provide for an absolute priority rule, as per the US Chapter 11. This means that there is significant scope for equity to retain value where there is a robust commercial rationale. The Virgin Active RP (*Re Virgin Active Holdings Ltd* [226-258]) established that it is within the gift of in-the-money stakeholders to determine how the restructuring surplus is allocated and that their decision cannot be challenged by out-of-the-money creditors. Further, the DeepOcean (*Re DeepOcean 1 UK Ltd* [62-64]) and Virgin Active (*Re Virgin Active Holdings Ltd* [259-300]) RPs established that the horizontal comparator test applied in CVAs is relevant to RPs. This provides that differential treatment of stakeholders, whose rights are equivalent absent an RP, is feasible provided there is a robust commercial justification. Nevertheless, the extent to which equity can retain a stake in the face of an in-the-money creditor challenge still needs further consideration by the court to establish the relevant parameters going forward and this will be a key issue for mid-market restructurings.

Costs

There are numerous factors which impact the level of costs in an RP and, to date, the costs incurred by some of the larger companies that have gone through RPs have been steep because of complex liability profiles which are not a good indicator for mid-market costs. The key issue for the RP's prospects as a mid-market tool is the risk of challenge and the resulting increase in costs. Greater legal certainty emanating from the courts considering different types of RPs to date has already significantly reduced concerns around challenger cost exposure. The judgments to date have been helpful in making it clear that there is no rule providing that the debtor should necessarily bear the challengers' costs but rather that challenger costs will only be borne by the debtor to the extent that the challenge played a constructive role in assisting the court with reaching its conclusions (Snowden J, *Re Amicus Finance plc* [2021] EWHC 2255 (Ch) [135-145]).

Timetable

The timetable for an RP plan is driven by the time required to ensure that stakeholders have sufficient information and the necessary time in which to consider it in order to make an informed decision as to whether or not to support the restructuring. The typical timeframe from launching an RP with a practice statement letter to sanction is six to seven weeks. Elements of this timetable could be significantly streamlined in certain circumstances in the mid-market. For example, where class issues are straightforward, the practice statement letter, that is typically sent to affected stakeholders ahead of the convening hearing to allow them to come forward and contest the proposed class composition at the convening hearing, could be dispensed with. Further, timeframes between the convening hearing and the RP meeting could be significantly curtailed if stakeholders are fully informed ahead of the convening hearing or where out-of-the-money stakeholders have been excluded following a successful s 901(c)(4) application.

CONCLUDING THOUGHTS

There is already significant support for the proposition that the RP is going to be an invaluable debtor-friendly restructuring tool. Concerns around cost and timing should dissipate as greater legal certainty around the RP's parameters develops from the growing body of RPs implemented in the top end of the market. Like the Scheme, CVA and Pre-Pack before it, the RP can be expected to develop in incremental steps through practitioner creativity and strong judicial support for developing the UK's rescue culture. The RP is a game-changing tool and it is likely just a matter of time before it is deployed at scale in the mid-market. ■