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The future of CVAs for restructuring lease liabilities: is the Part 26A restructuring plan the new tool of choice?

KEY POINTS

- Whether the new Part 26A restructuring plan will replace the CVA as restructuring tool of choice to restructure lease liabilities is likely to depend on all the circumstances, as recent court decisions affirm the utility and flexibility of both CVAs and restructuring plans.
- Restructuring plans offer distressed companies the flexibility of cross-class cram down. However, court involvement may be avoided in a CVA, and any challenge to a CVA would not be heard until after the compromises have come into effect.
- Evidence and fairness requirements are similar for both CVAs and restructuring plans. The likely costs of preparing and implementing the proposal for each will be similar, and it may be possible to avoid the costs of court action in a CVA.
- Whilst the restructuring plan certainly provides a flexible and holistic restructuring option, the CVA will remain a useful tool for distressed companies, and may continue to be combined with a Part 26 scheme if secured debt also needs to be compromised.

INTRODUCTION

The English courts have been busy with restructurings in the last few months, particularly those focusing on leasehold liabilities. We have seen the challenge to the New Look company voluntary arrangement under Part 1 of the Insolvency Act 1986 ('CVA') comprehensively rejected (*New Look Retailers Ltd (and others)* [2021] EWHC 1209 (Ch) ('*New Look*'), appeal pending), the *Regis UK Ltd* CVA challenge largely rejected (save in one limited respect) and the *Virgin Active* restructuring plan (under Part 26A of the Companies Act 2006 ('CA 2006')) sanctioned with landlords' vociferous objections swept aside (*Virgin Active Holdings Ltd (and others)* [2021] EWHC 1246 (Ch) ('*Virgin Active*')). In each of these restructurings, landlords have borne the brunt of the various compromises.

With the introduction of the restructuring plan by the UK Corporate Insolvency and Governance Act 2020, some observers may have predicted that CVAs would fade into the background, discarded as an older tool overshadowed by the flexibility of the new restructuring plan, including the powerful cross-class cram down mechanism. The (currently paused) National Car Parks Ltd ('*NCP*') restructuring plan is an example of a plan solely focused on compromising landlords (as opposed to financial creditors) and perhaps supports this view, though at the time of writing we are awaiting the outcome of the *NCP* plan.

Adding a new tool to the box does not necessarily mean that businesses stop using old tools when the need arises, but it introduces the question: will a restructuring plan's ability to cram down dissenting classes mean that it will always trump CVAs? To try to answer that question, we look below at some of the similarities and differences between the two processes.

RESTRUCTURING PLANS V CVAS

1. Creditor support

A fundamental question for a distressed company considering a CVA or a restructuring plan is whether they can persuade their creditors to vote in favour of it.

For a CVA, this will involve one meeting of all unsecured creditors (secured creditors and preferential creditors being joined into the CVA only with their consent). The *New Look* judgment firmly reiterated that all unsecured creditors (including secured creditors to the extent of any unsecured portion of their debt) vote together and there can be no separate classes for voting purposes. The fact that the vote is carried with any votes cast by unimpaired or differently-treated creditors does not cause automatic unfairness (although that will be relevant when considering the question of unfair prejudice).

By contrast, for a restructuring plan, creditors vote in classes and, subject to the cross-class cram down power, each of those classes must vote in favour of the restructuring plan. The class composition tests for restructuring plans track case law for schemes of arrangement under Part 26 CA 2006 ('Part 26 scheme'): the test is whether the interests of the members of a class are not so dissimilar as to mean that they cannot consult together with a view to their common interest. In a restructuring plan compromising lease liabilities, this class composition test may result in a significant number of classes (there were seven classes in each of *Virgin Active*'s restructuring plans and there are five classes in *NCP*'s restructuring plan).

However, and importantly, a restructuring plan may still be sanctioned by the court notwithstanding that a dissenting class has voted against it (so-called cross-class cram down) if the two conditions set out in s 901G CA 2006 are met:

- Condition A: the court is satisfied that none of the dissenting creditors would be

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worse off under the restructuring plan than they would be in the relevant alternative.

- Condition B: at least one class of creditors who will receive a payment or who have a genuine economic interest in the company has voted in favour of the restructuring plan.

If these conditions are satisfied then dissenting creditors may find themselves bound by a restructuring plan with a lower overall supporting vote than would be needed to pass a CVA.

A restructuring plan offers further flexibility in that debtors may rely on s 901C(4) CA 2006 and exclude a particular class from voting on the basis that the class is out-of-the-money or has no genuine economic interest in the relevant alternative. This route was not taken in *Virgin Active* (and has not been popular to date, possibly due to the risk that it creates another focal point for challenge) but the option to exclude a class demonstrates that the legislation is not intended to give out-of-the-money creditors any real influence over the way that assets are distributed.

When it comes to voting, therefore, the ability to exclude and/or cram down dissenting, out-of-the-money creditors could well make a restructuring plan the preferred choice. However, companies should also consider other factors when choosing a restructuring process, which may move the dial in favour of a CVA.

2. Timing and scope of challenge risk

An important factor for companies to consider is the point in time at which a creditor could challenge the restructuring and what the likely implications of such a challenge could be in the short and long term. Between CVAs and restructuring plans, the difference is largely one of timing, but there are also important considerations of possible grounds of challenge and available remedies.

Under a restructuring plan, challenges may be ventilated publicly in court at an early stage. The opportunity for challenge is front-loaded, as any dissentients may attend either the convening or sanction hearings to voice their objections with no need for the creditor to commence separate proceedings.

By contrast, court involvement with a CVA arises only if the CVA is challenged, so there is little formal opportunity for dissentients to voice objections until after the proposal is approved. A challenge to a CVA must be brought within 28 days of the filing date of the supervisor's report to the court of the outcomes of the creditors' and shareholders' meetings (or the date on which the creditor received notice of the CVA, if later than the creditors' meeting), so the window is short, requiring landlords to organise themselves quickly and commence proceedings (bearing the costs of doing so).

A key difference, therefore, is that a CVA is challenged only after it has come into effect, meaning that the company will be operating within the CVA's terms (and paying reduced rents) during the challenge process. If a restructuring plan is pursued, the challenge process plays out before the plan is sanctioned, so any delay caused by attacks on the restructuring plan could cause damaging prolonged uncertainty for the company. As such, the restructuring plan process may become more adversarial. In addition, the scope for challenge is wider than in a CVA, where the grounds for challenge are prescribed by law and limited to (i) unfair prejudice and (ii) material irregularity.

There is no way of avoiding court scrutiny in a restructuring plan – the court will probe the restructuring plan even if there is no formal challenge. Conversely, a CVA challenge may never get to court as it is open to the company to settle with the CVA challenger outside the confines of the CVA. Therefore, the way in which any challenge would play out could be influential when considering whether to restructure using a CVA or a restructuring plan.

3. Valuations and evidencing the relevant alternative

As part of the proposal process for either a CVA or a restructuring plan, a company will need to include cogent evidence as to valuation of available assets and the relevant alternative, to persuade creditors and the court that certain creditors are out-of-the-money or that insolvency is the appropriate comparator. As the court in *Virgin Active* confirmed, there is no absolute obligation to run a sales process to test the market but such a process is likely to be the best demonstration of asset value. In *Virgin Active*, Snowden J was prepared to hear extensive evidence on valuation, ultimately agreeing with the company's evidence that the value broke in the secured debt, leaving landlords out-of-the-money and unable to challenge the allocation of the benefits of the restructuring.

The proposing company will also need to demonstrate that creditors will be no worse off under the proposed restructuring plan than they would be in the relevant alternative. Where that relevant alterative is not imminent insolvency, it may be harder to persuade the court that the test is satisfied, as demonstrated in *Hurricane Energy Plc* [2021] EWHC 1759 (Ch) ('*Hurricane*'), where the court was not satisfied that the shareholders would be no better off under the relevant alternative as there were many variables that could affect their ultimate recovery.

These considerations of valuation and relevant alternative are an equally important part of a CVA proposal and, in the event of a challenge, the company must be ready to withstand similarly robust court scrutiny.

4. Fairness

Recent cases demonstrate that the tests for fairness in a CVA or a restructuring plan are overlapping and that compromises imposed on creditors under either process can be broad-ranging without automatically impugning fairness.

New Look confirmed that there is no rigid requirement for a landlord to receive at least market rent, or for the CVA to interfere with contractual rent only to the minimum extent necessary. Provided that a landlord can terminate the lease or receive a better outcome than in the alternative, any automatic unfairness from changes to the terms of the lease is negated. Whether a CVA is unfair depends on all the circumstances. The court in *New Look* also affirmed that CVAs may provide for different outcomes for different groups of creditors, provided such outcomes are justified.

Virgin Active confirmed that truly out-of-the-money creditors have little say and value may be allocated by the in-the-money

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class. Differential treatment of creditors (even within the same class) is permitted as long as it can be commercially justified and is disclosed to the creditors and the court.

Where an in-the-money class crams down another in-the-money class, the court will deliberate further on the question of how value is fairly allocated. In *Virgin Active*, the court rejected the argument that if conditions A and B (as set out above) were satisfied, the plans should be sanctioned unless the court thought that the plans were not just and equitable. Snowden J emphasised that the words 'just and equitable' do not appear in the statute (only in the Explanatory Notes) and therefore should not be read into it. Ultimately, in *Virgin Active*, given landlords were demonstrably out-of-the-money in the relevant alternative, Snowden J held that the fact the landlords were receiving something under the terms of the plan (rather than nothing in the alternative) made it difficult for the landlords to argue that the plan was either unfair or not just and equitable.

5. Costs

The costs of putting together a CVA or restructuring plan (and recoverability of such costs) will depend on the circumstances, but will be based on similar factors. However, if a restructuring plan is proposed, the company knows (and will inevitably have factored into its overall costs) that there will be two court hearings over a period of weeks and so the costs will be relatively certain (subject to any awards the court makes against the company in favour of dissenting creditors).

In general, the costs of a contested CVA that proceeds to a full hearing may be similar to the costs of a restructuring plan, but if no challenge is brought then a CVA is likely to be cheaper than a restructuring plan.

6. Secured and unsecured debt

A restructuring plan provides a company with the benefit of restructuring both secured and unsecured debt in a single process. This benefit, coupled with the possibility of cross-class cram down, may prove to be the deciding factor for some companies considering restructurings, particularly if the intention is to cram down secured creditors.

However, whilst a CVA cannot restructure secured debts itself, it can be combined with a Part 26 scheme if secured liabilities are also an issue (as in *New Look*). Companies can look to a long line of cases and previous precedents for both schemes and CVAs and they offer a well-understood mechanism, in terms of both voting and delivery. The court is able to draw from these cases for restructuring plans, but the newness of cross-class cram down in UK law means there is not yet the same level of jurisprudence.

7. Foreign recognition

Finally, a company must often consider whether its restructuring process of choice will be recognised in different jurisdictions. The decision in *Gategroup* [2021] EWHC 775 (Ch), which held that, from the perspective of the English Court, a restructuring plan ought to fall within the bankruptcy exclusion of the Lugano Convention, does raise considerable doubt as to whether using the Lugano Convention (if the UK's impending accession is successful) and the similarly-worded Hague Convention, are viable routes to recognition. However, debtors proposing recent restructuring plans have obtained expert opinions that recognition (either via Rome I, private international law, or other means) is likely in various jurisdictions. So to date, recognition concerns have not caused substantive issues. Debtors may also be able to satisfy the English courts of 'substantial effect' of the plan via alternative means, such as significant creditor support evidenced by lock-up agreements or similar.

Whilst Brexit has removed the automatic recognition of CVAs within the EU, debtors can still receive recognition for CVAs in other jurisdictions where needed (eg All Saints USA Ltd obtained recognition under Chapter 15 of the USA's Bankruptcy Code of its 2020 CVA relating to leases over properties in the USA).

CONCLUSION

At present, the momentum in restructuring arrangements appears firmly with tenants (albeit the market is paying close attention to *NCP*). This gives debtors the choice between: (a) the potentially cheaper, well-tried and tested CVA with a lower risk of a front-loaded challenge; and (b) the restructuring plan, which provides an holistic solution for a financial and operational restructuring, albeit with higher certain costs and a greater risk of challenge before the compromise is in place. The landlords in *Virgin Active* tried to argue that the companies' use of a plan rather than a CVA was deliberately aimed at removing landlords' negotiating leverage and the company agreed that the plan had a higher chance of success than a CVA. Snowden J commented that there was nothing '*inappropriate in the Plan Companies choosing to utilise Part 26A rather than a CVA if that appeared more likely to achieve the desired result of rescuing the companies in the interest of their stakeholders generally*', so affirming that distressed companies have a genuine choice between the two processes.

Deciding which restructuring process will be appropriate for a distressed company will depend on the circumstances at hand (including as the economy emerges from COVID-19 whether landlords and tenants are able to agree how to deal with COVID-19 rent arrears), but it seems clear that, whilst the restructuring plan has provided a viable new tool for restructuring lease liabilities, there is still plenty of life left in the CVA. ■

Further reading

- LexisPSL Restructuring and Insolvency; Property Insolvency; Company Voluntary Arrangements; Company voluntary arrangements in property insolvency – overview
- LexisPSL Banking and Finance; Restructuring; Restructuring Options and processes; A hat trick of leading decisions on creditor cram downs – treatment of landlord groups in *New Look*, *Regis* and *Virgin Atlantic*
- The impact of COVID-19: how the pandemic has shaped real estate financing in the retail and hospitality sectors (2021) 1 CRI 39