Case notes:
UK cram down in practice.

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We commented on the Corporate Insolvency and Governance Act 2020 (CIGA) and its 'cross class cram down'. The new provisions offer tools to support a fresh start for businesses in financial difficulty and avoid insolvency and a fire sale of assets. This article looks back at early judicial approaches to the new power and the central importance of valuation evidence in the positioning of interested parties in a restructuring plan.

During 2021 leading insolvency judges in the English High Court have addressed the practical functioning of these new statutory provisions for restructuring plans in the UK, in particular in Re Virgin Active Holdings Limited [2021] EWHC 1246 and Re DeepOcean 1 UK Ltd [2021] EWHC 138 (Ch). As predicted in our earlier commentary, a central factual issue in the cases has been value and the key role valuation evidence plays in the outcome of a disputed application to court to sanction a restructuring plan. This note considers the position of dissenting creditors – likely to be the outsiders to secretive bilateral negotiations involving senior secured creditors and the affected companies – and recommends prompt attention to expert valuation evidence.

First, the wide 'compromise or arrangement' gateway wording in s.901A(3) Companies Act 2006 has been treated with appropriate judicial robustness. This requirement is unlikely to stand in the way of a Part 26A restructuring plan and CIGA restructuring plans were used to restructure Virgin Atlantic Airways Limited in September 2020 and PizzaExpress Financing 2 plc in October 2020.

The DeepOcean decision handed down on 28 January 2021 sanctioned the first restructuring plan to include a cross class cram down under the new provisions. As Mr Justice Trower explained in his judgment, new section 901G of the Companies Act 2006 introduces a procedure by which a dissenting class can be bound by a restructuring plan, that is to say, against their will. This includes subjecting parties to new terms for their credit or having their shareholder rights disapplied and, as a use of state force to override private law rights, involves the exercise of the court's discretion after the determination of key threshold issues established by the statute. First, the rules require the court to determine that dissenting creditors stand to lose nothing because they would be out of the money anyway or served better by the plan ('none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative', ie in the most likely outcome in the court's view if the plan were not sanctioned). Second, the rules require the compromise or arrangement to be approved by at least 75% by value of at least one class of creditors which would have a genuine economic interest in the company in that relevant alternative (ie one 'in the money' class). The court need only consider the relevant alternative as at the date of the sanction hearing. In DeepOcean, the court had before it evidence that the relevant alternative was an administration or liquidation of the relevant companies and accepted both that the restructuring would lead certain creditors to receive at least 4% more than they would in an administration or liquidation of the relevant companies (the relevant alterative, which would lead to nominal or nil returns) and that a class of (secured) creditor approved the plan and would have received payment in an administration or liquidation.

In Virgin Active, the company proposed restructuring plans with its creditors and the court sanctioned plans although a number of classes of creditor voted heavily against the plans. Deloitte reported for the company, modelling two scenarios for the administration of the group assuming the restructuring plans were not approved. Instructions were given in early February 2021, according to the case report (paragraph 49). The information used by Deloitte to prepare their report included the analysis set out in a valuation report prepared by Grant Thornton on 18 March 2021, with a valuation date of 18 February 2021, which was in turn based upon information provided to Grant Thornton by management. These dates are likely to be the formal final report dates and may give little clue as to when Grant Thornton and Deloitte actually began working with management and whether they also worked with the secured lenders behind the scenes. The likelihood would seem to be that this inner circle worked for some months before reporting formally and the landlords were thus probably on the back foot even if they had immediately, in February 2021, commissioned valuation work.

The court considered criticisms of the Deloitte/ Grant Thornton approach. Although only based on desktop valuations and based on Virgin Active's own business plan with management's 5-year forecast, unaudited by the valuer (although discussed and tested and found to be "reasonable"), there was only one formal valuation before the court. The dissenting landlord classes did not offer a competing valuation report and the work of those associated with the business was given the green light by the court. This was inevitable and highlights the need for dissenting classes to prepare their own valuation evidence, possibly in a short time frame and with significantly less information than their opponents who favour the restructuring plan.

The court saw some evidence of independence of mind as between Deloitte and Grant Thornton (see paragraphs 97-99 of the judgment). The total estimated sale proceeds were £179.3 million which, when combined with other realisations of £44.3 million, gave a total estimated realisation of £223.6 million. This was £39 million less than the amount required to clear the secured debt and other priority claims, with the result that, on Deloitte's view, the relevant unsecured creditors would be out of the money and the distributions to them in an administration would be limited to a de minimis share of the prescribed part.

The court considered that "most importantly" (paragraph 52), on either of the two scenarios modelled by Deloitte, value broke in the secured debt. This left a shortfall for the secured creditors (even on the most likely alternative to the restructuring plans, according to Deloitte, which was an administration in which the secured creditors would fund an accelerated sale process carried out by administrators). As commented above, this conclusion is fatal to dissenting creditors who seek a say in the restructuring plan. Such a conclusion flows from the factual or expert evidence before the court, even if there are credible arguments that the production of that evidence was a process cloaked in secrecy, one-sided and liable to favour the secured creditors with whom the company had liaised closely for a lengthy period.

The landlords did question the reliance that the court should place on Deloitte's report. They also challenged the provision of information to them. There was rigorous testing of the evidence by live (remote) cross-examination of witnesses including the accountancy and valuation witnesses. One Deloitte witness dealt with the adequacy of information provided to the landlords. Another addressed criticisms of the approach taken by Deloitte and the business to the Deloitte report. A Grant Thornton witness addressed criticisms made by landlords of the approach to the Grant Thornton Report which formed the basis for the valuations of the relevant companies. The landlords fielded PwC witnesses (whose firm's work in a Scottish case was put back to them in cross-examination, based as it was on desktop valuation work).

The judge dismissed complaints that landlords were excluded from negotiations in respect of the restructuring and the plans, provided with little or no information (and had to fight for what they got) and prevented by confidentiality undertakings from discussing matters with relevant parties. The judge held that they had been provided with "an enormous volume of information and documents", could have made an application to court if they were dissatisfied with the disclosure given and that it was "appropriate and procedurally fair that I should proceed on the basis of the evidence before me".

In short, valuation battles will be fought on their merits and not on procedural grounds; as a result, dissenting classes must put together compelling evidence supporting an argument that they have an economic interest in the court decision on sanctioning the restructuring plan, rather than rely on criticisms of the other side's approach.

The judge noted that the possibility of the Part 26A regime giving rise to valuation disputes was foreshadowed in the Department for Business, Energy & Industrial Strategy's response to the outcome of its consultation on "Insolvency and Corporate Governance", published on 26 August 2018[1]. The judge commented: "As that response makes clear, it is obviously important that the potential utility of Part 26A is not undermined by lengthy valuation disputes, but that the protection for dissenting creditors given by the "no worse off" test (and the Court's general discretion) must be preserved."

As to the detail of the valuation approach, citing Howard & Hedger: Restructuring Law and Practice, the court noted the "need to be cognisant of the strategic incentives to overvalue or undervalue the company's business". Paying deference to City institutional advisers, the judge decided that there was no need for market testing since "it was [not] unreasonable for the Plan Companies to follow the advice of their advisers, who did not recommend such a process". The judge also cited Debt Restructuring and Notions of Fairness (2017) 80(4) MLR 600, in which Professor Sarah Paterson considered the approach traditionally taken in scheme cases such as Bluebrook to creditors who are left out of a scheme on the basis that they would be out of the money in a formal insolvency. The professor commented on the difference between US and UK approaches, noting that "the English court puts particular weight on the position the creditors would be in if the scheme of arrangement were not sanctioned. Where the company is financially distressed, this typically leads to an

[1] At paragraph 5.172: "…disputes over valuation may result in costs and delay to restructuring plans being confirmed or not… there are many valuation methods in common use … creditors can challenge if they do not agree with the company's choice. Assets, such as intellectual property or goodwill, are difficult to value objectively and may lead to further dispute when valued for a restructuring plan. The Government's objective is to minimise the likelihood of challenge so far as is possible, whilst providing the underlying protection to creditors that such a safeguard is meant to offer".

inquiry into whether the price which an administrator would receive in a market sale of the business and assets at the time of the restructuring would be sufficient to make a distribution to the creditors excluded from the scheme. … US bankruptcy law adopts a valuation standard based on professional valuation opinions, rather than current market price established through an auction process… such as discounted cash flow, comparable transaction and private equity valuations in an attempt to give more credit for the prospect of a post-restructuring recovery in the price of the business and assets than a purchaser in the distressed market at the time of the sale might be willing to give." There is ample scope to criticise the fairness of the UK approach, which appears supportive of banks and financial institutions at the expense of other interests.

Attempts were made to undermine the valuation evidence on technical grounds to argue that the estimate of the expected proceeds of the sale of the relevant (regional) businesses was too conservative, including that the lower case valuation multiple was too low and that the weighted average cost of capital and long-term growth rates used by Grant Thornton in preparing its report were unduly conservative. These attempts came to nothing.

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