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A New Restructuring Plan

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For over a century, U.K. company law has enabled a company to propose, to its creditors or shareholders, a compromise or arrangement of their rights which, if approved by the requisite majority and then by the court, is binding on all of the relevant creditors or shareholders. This process—a scheme of arrangement under Part 26 of the Companies Act 2006—has been frequently used by companies (including those non-U.K. companies that fall within the winding up jurisdiction of the English courts, to whom the court's scheme jurisdiction extends) to implement a wide variety of different forms of financial restructuring, despite it not being a formal insolvency proceeding. In June 2020, the U.K. Government introduced a new form of restructuring plan under a new Part 26A of the Companies Act 2006, that would be focused on the needs of companies facing financial difficulties. In this briefing, we examine how the new restructuring plan differs from a scheme of arrangement and how it is likely to be used going forward.

INTRODUCTION

In its 2018 Insolvency and Corporate Governance Response (the "Government's 2018 proposals"), the Government recognised the need for a new form of restructuring plan (the "Plan") that would sit alongside schemes of arrangement and would be focused on the needs of companies facing financial difficulties. The Corporate Insolvency and Governance Act 2020 ("CIGA") introduced the Plan by inserting a new Part 26A into the Companies Act 2006 ("CA").

While much of the Plan legislation looks similar to the existing scheme legislation, there are six key changes.

I. Availability of the Plan

In order to use a Plan, the company must be in financial difficulty, and the Plan must address that financial difficulty.

II. Disenfranchisement

The company can apply to court to disenfranchise a class of creditors or members from voting if that class has no genuine economic interest.

III. Numerosity

The majority required to approve a Plan is now 75% or more in *value* in each class of those voting (subject to disenfranchisement or cram down) and, in contrast to a scheme, there is no additional requirement to have a majority by *number* of those voting to approve.

IV. Cram Down

Probably the most significant change, and a novelty in U.K. restructuring law, is the ability to "cram down" via court sanction, another class (or classes) of creditor or member, potentially even a senior class, that votes against the Plan. In contrast, under a scheme, each class has an effective veto on the scheme compromising their rights.

V. Moratorium Veto

A special category of moratorium creditors (if the company has entered into a moratorium before the Plan) may have a veto on the Plan's application to them (and also any legacy scheme).

VI. Pensions

Last minute amendments to the legislation give certain defined benefit pension related persons notification and potentially voting rights.

PROCESS FOR IMPLEMENTING A PLAN

Before examining the new changes, it is helpful to examine the Plan process generally.

The new Plan procedure will operate in a very similar way to the way in which schemes operate. This is evident from the first Plan very recently proposed by Virgin Atlantic.

This means that, apart from the basic legal requirement of having to involve some form of compromise of rights as opposed to their mere confiscation, there will be few limits on the types of restructuring in its Plan that a company may propose to its creditors or members for their approval. Schemes will also remain a viable tool for companies that do not (or choose not to) satisfy the financial difficulty conditions or do not need to rely on any of the other key features of a Plan. Schemes in particular will continue to be used by solvent companies (for example, shareholder schemes of arrangement) to implement corporate shareholder transactions.

Like a scheme, a Plan may also make provision for the reconstruction or amalgamation of companies under which the whole or part of the undertaking or property of the "Plan" company is transferred to another company, although the limitations in *My Travel* (requiring there to be a substantial similarity as between the shareholders of the transferor *and* the transferee company) and *Doncasters v Nokes* (a transfer not being capable of overriding restrictions on assignments) will continue to apply.

An application to the court will be required, both to convene meetings of creditors or members to approve the Plan and to seek the court's sanction of the Plan once it has been approved. The Plan will bind all affected creditors or shareholders (referred to as members), whether or not they voted in favour of the Plan.

New Practice Statement

A new Practice Statement has been issued by the courts setting out the process to be followed when applying to initiate a scheme or a Plan and this focuses very much on ensuring adequate notice is given to creditors or members of the convening hearing (to allow class and disenfranchisement issues to be raised in good time). It is anticipated that the Practice Statement Letter approach of sending a letter with sufficient information for complex schemes will be used for Plans. In *Re ColourOz* at the convening hearing, the court was keen to emphasise the application of the new Practice Statement and the importance of sufficient notice being given.

Convening Hearing—Order to Convene Meetings

A company wishing to initiate a Plan must apply to the court for an order convening a meeting or meetings of creditors or members to approve the Plan. An application may also be made by a creditor or member of the company, as well as by its liquidator or administrator, although, as with schemes, there would likely be significant practical, as well as legal, difficulties for a creditor or member who wished to propose a Plan without the support of the company concerned.

Under the scheme process, while creditors are theoretically able to propose the scheme, this is rarely done because (i) creditors may not have access to all the information that the court would expect to be disclosed to other creditors or members in the explanatory statement which is required to be disseminated as part of the process and (ii) the court requires the company to have approved the scheme, see *Re Savoy*.

This poses some issues in relation to creditors wishing to promulgate a scheme against the wishes of the shareholder(s). Often, this is achieved by ensuring that the directors (including those appointed by the shareholder) are aware of their duties to act in the interests of the company, which, in a restructuring context, very often means the creditors. Further, under English law, certain steps can be taken to prevent destructive shareholder action (for example, restraining shareholder resolutions to wind up a company) or creditors may be in a position to apply to put the company into administration which will then allow the administrators to manage the company and promulgate the scheme. It will be interesting to see if the courts reassess *Re Savoy* in the Plan context, given that the Plan specifically allows for potential shareholder disenfranchisement or cram down.

Classes

The court will determine the choice of classes, voting requirements for, and composition of, any separate classes of creditors or members that are required to approve the Plan, on the basis of the well-established principles that the court applies in the case of scheme meetings. In particular, it is expected that the court will continue to adopt the decision in *Re Garuda* in relation to the company's choice of creditors to be included within the class or classes of creditors invited to vote (i.e. there must be some proper rationale around the choice of, and therefore potential exclusion of, creditors to be convened to vote) and to scrutinise the constitution of classes carefully (see *Re Virgin Atlantic* in relation to a Plan, in particular where certain low value trade creditors were excluded from the trade creditor class). The constitution of classes goes to the court's jurisdiction to sanction a scheme (i.e. it has no discretion to sanction a scheme where the classes are incorrectly constituted). This is equally likely to be the case under the new Plan regime.

In relation to schemes, the court will assess class constitution by reference to the creditors' (or members') legal rights and by determining whether those rights within the class are not so dissimilar as to make it impossible for those within the class to consult together with a view to their common interest (the so called *Sovereign Life v Dodds* test). This entails an examination of both the legal rights being affected by the scheme and the legal rights coming out of the scheme, with an emphasis on legal rights as opposed to mere interests (interests often being relevant to fairness, not classes), see *Re Telewest*. This is to ensure that creditors are not oppressed by a majority of other creditors with different legal rights and to ensure that each properly constituted class has a vote on the scheme (with the corresponding veto carried by each class).

Given the existence of cram down, a company may now be positively incentivised not to minimise classes but to expand them with a view to using cram down to deal with dissenting classes and avoid a class veto—a point recognised by the court in the convening and sanction hearings under the new Plan legislation, *Re Virgin Atlantic*. There has been some commentary that the courts may be more relaxed in terms of class constitution under Plans in light of cram down, but this is overly simplistic and the precise approach is likely to be very fact-specific. It seems clear that there may be cases where the court will consider that classes have not been correctly constituted if creditors with similar rights have been placed into separate classes *simply* to allow the company to avail itself of cram down to deal with a dissenting class in circumstances where the cram down would not otherwise have been available if the class had been otherwise constituted and the requisite majority in that class would not have otherwise approved the Plan (because the dissenting creditors had a sufficient blocking position). Such a step would require much greater justification. Even in the scheme context, courts have been keen not to unduly fracture classes (albeit to avoid giving an unnecessary veto to a separate class within a scheme) and it is likely that the opinion expressed in *Re UDL Holdings* that where the rights are sufficiently similar, creditors *should* be placed in the same class may apply to prevent a new class being created simply to exploit the Plan cram down option (where such cram down option would not otherwise exist). The need to continue to satisfy the court that classes have been correctly constituted has been made clear in the context of Plans in *Re Virgin Atlantic*, although the court did not have to review the precise issue around fracturing classes with similar rights raised above.

Plan Meeting(s) Approving the Plan

Except where the "disenfranchisement" or "cross-class cram down" provisions apply (see below), approval of the Plan will require the vote in favour of 75% in value of the creditors or members in each class present and voting. Unlike the approval requirements for a scheme, there is no additional "numerosity" requirement that the vote also comprises a majority in number of the relevant creditors or members voting. However, neither is there a requirement—as was promised in the Government's 2018 proposals—that more than half of the total value of unconnected creditors vote in support of the Plan.

Sanction Hearing—Order to Sanction the Plan

Just like a scheme, a further court application must be made to sanction the Plan. At sanction, the court does not merely rubber stamp the meeting result, but will, among other matters, consider whether the scheme is "fair" (see below) such that it should exercise its discretion to sanction the scheme. The same approach is expected for Plans, although the considerations in relation to fairness are likely to change to reflect the application of cram down (see below).

Following the court's sanction, the Plan will become effective and bind all the classes of creditors and members who are a party to it (including any class that was "crammed down" and individual creditor or member who voted against it or did not, or because of disenfranchisement, could not vote at all).

Where the company proposing the Plan is regulated by the PRA or FCA, its regulator will be entitled to be heard by the court at any application to convene meetings and to seek the court's sanction to the Plan.

AVAILABILITY OF THE PLAN

Companies

The Plan will be available to the same type of companies as can presently use schemes and this will therefore include non-U.K. companies which have a "sufficient connection" to the U.K. It will also be available to certain other entities such as limited liability partnerships. This is important as the well-established route for using schemes for overseas companies will still apply in relation to a Plan. This will include demonstrating a sufficient connection by reference to the English governing law of the obligations to be compromised (including changing that law to English law if necessary, see *Re Apcoa* and more recently *Re Syncreon*) or, if those obligations are governed by overseas law, by demonstration of recognition of the scheme (or Plan) by that overseas law (typically for NY law by demonstrating that the U.S. court would recognise the scheme under Chapter 15).

Complications may arise if a Plan seeks to modify shareholder rights (or seeks to cram down shareholder interests) where those shareholder rights are governed by the foreign law of incorporation of an overseas company, as generally, those rights tend to be recognised solely by that foreign law. This may mean that some other mechanism, for example, local security enforcement, is used to deal with shareholder rights.

Financial Difficulty

In contrast to schemes, the Plan requires two key conditions to be satisfied before it can be used, see section 901A CA; (i) the company must have, or be likely to have, *financial difficulties* affecting its ability to carry on business as a going concern, and (ii) the purpose of the Plan must be *to eliminate, reduce or prevent, or mitigate the effect of those financial difficulties*. These conditions are jurisdictional and therefore *must* be satisfied. Since the concept of "financial difficulty" is potentially very broad—potentially much broader than the insolvency concept of "inability to pay debts"—there may be some debate as to how onerous a requirement this will be for a company wanting to make use of the Plan (and especially its "cross-class cram down" facility). The court in *Re Virgin Atlantic* noted the broad definition and the legislative intent to allow Plans to be used in a restructuring context, and we would not expect that the conditions would require the court to engage in a forensic exercise to determine the long-term viability of the Plan, unlike, for example, the more onerous position in U.S. Chapter 11.

Exclusions

Entities that are regulated by the PRA will require its consent before applying to the court to initiate the Plan process, and the Secretary of State may, by regulation, exclude certain financial services entities that are authorised under the Financial Services and Markets Act 2000 and certain other companies or those with certain types of creditors from making use of a Plan.

DISENFRANCHISEMENT OF CREDITORS OR MEMBERS

Certain creditors or members may also be excluded from voting on the Plan. Ordinarily, every creditor or member whose rights are affected by the Plan must be permitted to participate (in this sense, vote) in a meeting convened by the court, and this is reflected in section 901C(3) CA. However, this section does not apply if on an application by the company (by implication at the convening hearing stage) the court is satisfied that *none* of the members (i.e. creditors or shareholders) of that class has a *genuine economic interest in the company*, see section 901C(4) CA.

There has been some differing market commentary about what this provision actually means and whether it allows a Plan to compromise completely out of the money creditors or members without requiring them to vote and thereby deal with those creditors or members under the Plan by, for example, releasing their claims and allowing the Plan to restructure the company without requiring a further separate legal process to eliminate those completely out of the money claims (for example, a security enforcement or administration process).

Under existing scheme case law, creditors with no economic interest can be excluded from voting on a scheme, but equally, this means that they cannot not be bound by it and so some other mechanism needs to be used to deal with their residual claims (e.g. security enforcement or administration to transfer the business and assets to a new company and to leave those residual claims stranded against the legacy rump company), see *Re Tea Corporation*. It would seem odd that the new legislation simply sought to reflect the position at common law—rather it suggests that it seeks to achieve more. Section 901C(4) specifically references the disapplication of the entitlement to vote on a Plan provided that the class has no genuine economic interest but does not state that such a class shall not be bound by the Plan. This suggests that the Plan can indeed bind them and deal with their residual claims.

This raises a number of questions. The courts will need to clarify what a company will need to demonstrate before the court will be satisfied that the class has no genuine economic interest and how far this provision allows disenfranchised creditors or members to be affected by the Plan. The courts are likely to review how the legacy scheme case law around the need to have a genuine compromise (i.e. give and take, see *Re NFU* and more recently *Re Lehman Brothers*), as opposed to mere appropriation, will apply in the Plan context. Of interest, at the *Re Virgin Atlantic* convening hearing, the court considered that there was no reason to consider that the approach to assessing what was capable of amounting to a compromise or arrangement should be any different from schemes—but the court did not have to consider this issue in the context of disenfranchisement or cram down, which, given the legislative provisions, may require a different approach in that specific context.

In terms of no genuine economic interest, the reference to "genuine" suggests a non-fanciful interest. This suggests that an affected class is unlikely to be able to argue that they have a mere hope of some economic return (e.g. based on more speculative economic modelling, see the arguments raised and dismissed by the court in *IMO Carwash*). It is thought that the court is likely to apply a similar test to cram down (on which, see further below) and the consideration of what that relevant alternative might be in determining whether they have any genuine economic interest in that relevant alternative. It would be surprising if a different threshold or evidential requirement was developed for disenfranchisement, which could otherwise give rise to odd and inconsistent results as between disenfranchisement and cram down.

It seems clear that the company must make the application at the convening hearing stage. This, therefore, introduces a timing issue, as the court is likely to require adequate notice to be given to the class so concerned (see, in particular, the new Practice Statement) and if an objection is raised, this will likely impact the Plan timetable. A company will need to consider strategically whether it wishes to disenfranchise a class from voting or whether it wishes to allow them to vote, perhaps incentivising them to do so, and then to seek to cram them down at the sanction stage if the requisite majority do not vote in favour.

Equally, it is hoped that if the court has determined disenfranchisement at the convening hearing, the issue will not be heard again at sanction without good reason (for example, a disenfranchised creditor or member demonstrating that they did not receive proper notification of the convening hearing). This is especially so given the need to give proper notification under the new Practice Statement.

The reference to "none" of the members of the class having a genuine economic interest suggests that the position will be assessed by reference to individual class members—so if one has an interest, disenfranchisement will not be possible. However, it is likely that the court will assess that position in terms of the member's position as a member of that class—i.e. what legal rights are being compromised in that class, rather than taking into account individual ancillary interests (for example, cross holdings) that the member of the class may have, in his capacity, as a member of another class. Similarly, the reference to economic interest "in the company" suggests that interests outside, e.g. in guarantors, may be irrelevant.

NUMEROSITY

The absence of a numerosity requirement for Plans has been noted above. This is consistent with the Government's 2018 proposals and similar moves in other jurisdictions, where a numerosity requirement has been seen as increasingly hard to justify. This will be of real relevance where a company has a large number of small value creditors who might otherwise represent a holdout risk under the scheme numerosity limb.

CROSS-CLASS CRAM DOWN

Perhaps the most novel and important feature of the Plan, when compared to a scheme, is that whereas a scheme requires the approval of each separate class of creditors or members voting on the scheme, it will be possible, in certain circumstances, for a Plan to be approved even when it fails to obtain a 75% vote in favour from one of the classes voting on it. This will provide a very useful tool for a company that is faced with "hold out or ransom" creditors since those creditors will be denied the effective veto right that they would have under a scheme as a dissenting class of creditors.

Under section 901G CA, this so-called "cross-class cram down"—forcing a whole class of creditor to accept and to be bound by a Plan once it is sanctioned by the court, even though the class itself (by more than 25% in value vote) has not approved it—will require two conditions to be satisfied.

The first condition is that none of the dissenting class would be "any worse off than they would be under the relevant alternative." For these purposes, the "relevant alternative" is whatever the court considers would be most likely to occur if the Plan is not sanctioned.

The second condition is that the Plan has been approved by one class that would receive a payment or have a genuine economic interest in the company, under the relevant alternative.

If those conditions are met, the fact that the dissenting class has not agreed does not prevent the court from sanctioning the plan under section 901F CA. Under section 901F, the court *may* sanction a Plan, and scheme case law has developed the criteria the court will assess in exercising that discretion (see below).

Regulations may be made under the legislation adding to, removing or varying these conditions. This suggests that it is anticipated that issues may arise which will require further secondary legislation to address.

The assessment of the relevant alternative is likely to be highly fact specific and some similarities are likely to be drawn from the comparator test that has developed in schemes (principally used for assessing the differences in legal rights for class purposes). First, it will require evidence around what the actual alternative (absent the Plan) might be, for example administration, liquidation or even an alternative restructure (although, precisely what that might comprise, may be difficult to determine). Second, it will require more valuation-based evidence on what the potential outcome might be in that alternative—this will be necessary to form the baseline against which a dissenting class' alternative return can be compared to what they are being offered under the Plan. Such evidence may be complex and is likely to be the subject of differing views and therefore litigation. The views of those subject to cram down are likely to contrast starkly with those of the company and other supporting creditors, particularly if the Plan and relevant alternative result in very different outcomes (e.g. a liquidation dividend in the alternative or some contingent interest under the Plan). Such litigation will have a potential impact on the scheme timetable and the courts will need to manage such litigation efficiently in urgent cases to avoid the Plan process being dragged out and the company being forced into the very alternative it is seeking to avoid.

Equally, it will be interesting to see how the courts deal with the evidence and what precisely will be required to be demonstrated. The court will ultimately have to take a view on a likely future scenario absent the Plan—that will involve an assessment of the likelihoods of various alternatives and may also involve the assessment of the likely behaviour of certain key stakeholders. For example, supportive senior creditors may maintain that the Plan is the only deal they are prepared to accept, and absent that Plan, they would enforce their security as opposed to pursuing an alternative going concern restructuring. The commercial reality may, of course, be different, particularly if enforcement is value destructive. See, for example, the contrasting positions between company, supporting and opposing creditors in the Scottish scheme *Re Premier Oil*. It will be difficult for the courts to assess the likely commercial position of creditors and how they may act (rationally or otherwise). The court may seek to avoid the analysis of such difficult issues by adopting a more legalistic based approach which focuses on senior creditor rights to enforce in such circumstances, rather than entertaining evidence as to how they may act, but that remains to be seen.

Senior Creditor Cram Up

The cram down provisions are broad and do not preclude the possibility of a senior creditor cram up—namely, a dissenting *senior* class of creditors being crammed down by a *junior* class of consenting creditors. Further, the Plan does not include the further protection of an absolute (or modified) priority rule (on which, see below), despite this being suggested in the Government's 2018 proposals.

Practically, achieving a senior creditor "cram up" may be difficult. First, senior creditors may have a right of enforcement which means that if they do not support the Plan, they remain free to enforce their security (normally over a holding company, the operating company and/or its business and assets). Unlike U.S. Chapter 11, the Plan does not, of itself, carry a moratorium over security enforcement (and while the courts have granted a stay in relation to judicial enforcement of debts pending a scheme, it is unlikely that such a judicial stay would extend to preventing the enforcement of English security). Although a new moratorium regime is now available and could be used alongside a Plan, it has a number of significant limitations, meaning that it will not be available to most issuers of listed and traded debt capital market instruments and most financial debt will not be subject to any moratorium.

This means that, in most situations, it will be necessary to have the support of senior secured creditors (or the majority able to control enforcement) to avoid those creditors simply enforcing as an alternative to the Plan. However, there are circumstances where senior secured creditors may have ceded enforcement control to junior creditors, in which case, they may not have the option to enforce as an alternative (at least not before the Plan may become legally effective and compromise their enforcement right). This is often the case in super senior RCF/bond structures or unitranche structures, where super senior bank lenders may have provided a modest RCF facility in return for sitting at the top of a large security arrangement, which also secures the larger bond exposure. Those arrangements may be vulnerable to cram up.

That said, such cram up poses other complexities. It will still be necessary to demonstrate that such senior secured creditors are no worse off than they would be in the relevant alternative. That relevant alternative is likely to be some form of security enforcement absent the Plan (even if not an immediate enforcement) where the senior secured creditors are likely to demonstrate that, by sitting at the top of the security waterfall, they would receive full cash payment. The Plan may, in contrast, seek to roll over that debt in a restructured and stronger borrower (perhaps with a coupon adjustment to compensate for the extension and continued credit exposure). Individual issues (e.g. a creditor's cost of capital) may also be relevant.

Further, a company may not be able to simply roll over a senior secured facility. In *Re Apcoa* the court held that the scheme legislation did not allow a company, through a scheme, to impose obligations on creditors as part of the compromise—the compromise could only affect creditors in their capacity as creditors of the company (i.e. claims creditors have against the company). This is likely to be the same for Plans. Consequently, only pure debt could be rolled over—to the extent that the company requires lender obligations (e.g. obligations to provide further advances, guarantee further LCs etc., typically found in RCFs), that is unlikely to be possible without contractual consent or other parties agreeing to provide those facilities (and then considering how that can be provided at the appropriate security level).

Equity Cram Down

The legislation appears to allow for a creditor class to cram down shareholders. Indeed, the legislation provides for ancillary amendments to the CA which facilitate the disenfranchisement or cram down of shareholders and disapplies certain of its shareholder protections which would otherwise require their assent by resolution, for example, the requirement for shareholder approval to issue new shares and the application of shareholder pre-emption rights.

The ability to deal with dissenting shareholders is important and will facilitate restructurings for PLCs and companies with large bodies of disparate shareholders or, indeed. will allow a restructure to be implemented without necessarily requiring some form of enforcement procedure or administration to transfer the business and assets to a new company, owned by new shareholders (invariably, the creditors converting their debt into equity). It is now possible for the company to issue new shares to those converting creditors without requiring existing shareholder authority to allot or to disapply pre-emption rights, meaning that a holistic restructure of the company and its equity structure can be achieved.

That said, the issues identified above where shareholders do not support the Plan, or where the company is an overseas company, may complicate the restructure, and it is for this reason that an enforcement process or insolvency process may still need to be used.

Impact of Changes on Court's Discretion at Sanction

Approval of schemes have always been subject to the court's discretion, and this will be the case for Plans. The criteria for scheme sanction are not set out in legislation but have evolved in case law (see, for example, *Re National Bank* cited and approved in *Re Telewest* and numerous cases thereafter). They include assessment of the following:

- whether the legislation has been complied with (this would include matters going to the court's jurisdiction prescribed by statute, e.g. proper constitution of classes, jurisdiction over the company or compliance with other statutory requirements);
- whether the class was fairly represented by those who attended the meeting (e.g. turnout);
- whether the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class they purport to represent (e.g. ancillary interests, for example, the impact of cross-holdings); and
- whether the scheme is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve (this encompasses a broader fairness assessment and will often be influenced by the actual meeting outcomes and analysis of how those in similar positions actually voted).

In addition, the court does not simply assess whether the majority are acting bona fide, but at the same time, will be slow to differ from the meeting, unless the class has not been properly consulted, or the meeting has not considered the matter with a view to the interests of the class which it is able to bind or some blot is found in the scheme.

That test also makes clear that the scheme proposed, need not be the only fair scheme or even, in the court's view, the best scheme. Necessarily there may be reasonable differences of view on these issues.

The court has also recognised that in commercial matters, members or creditors are much better judges of their own interests than the courts. Subject to the above considerations, the court "will be slow to differ from the meeting".

In *Re Noble* (in relation to a scheme) and in *Re Virgin Atlantic* (in relation to a Plan), the court paraphrased the above tests as essentially a four-stage test assessing whether:

- the provisions of the statute have been complied with;
- the class was fairly represented by the meeting, and whether the majority was coercing the minority in order to promote interests which are adverse to the class that they purported to represent;
- the scheme was a fair scheme which a creditor could reasonably approve; and
- there is any "blot" or defect in the scheme.

Importantly, in *Re Virgin Atlantic*, the court specifically referred to the application of the four-stage test when sanctioning the Plan, stating that it was prepared to follow the "tried and tested" approach to the exercise of discretion for schemes. The court did not have to consider the application of cram down on the facts of the case.

As can be seen, while some of these scheme tests are clearly relevant to assessing the position *within* a class and whether the majority should be allowed to bind the minority within that class—those tests should also apply to Plans. However, the case law will need to evolve further to address fairness in the context of the new Plan features, including cross-class cram down which applies *across* classes and where a class meeting may differ in view from another class meeting.

In terms of the application of and potential judicial limits to cram down, some of the criteria may inevitably evolve as part of the courts' determination of whether the dissenting class is no worse off than they would be under the relevant alternative (being one of the statutory conditions to cram down). However, it is likely that further criteria will need to be developed. For example, it would appear possible for cram down to operate in circumstances where the statutory condition is technically satisfied, but a very small by value class of creditors has consented and an overwhelming large by value class of creditors dissent—will the court allow that class to be crammed down when it is clear that the overall body of creditors do not approve? What factors will the court take into account in such circumstances? It is interesting to note that the legislation does not include an overall majority test as proposed in the Government's 2018 proposals.

Further, a restructure will invariably preserve or even create future value compared to an alternative of liquidation—there appears to be no restriction on how that value is allocated as part of the restructure and provided the dissenting class is "no worse off" in the relevant alternative, cram down can apply. It is noticeable that the concept of absolute or modified priority was not introduced as part of the cram down conditions despite (as already noted) being included in the Government in its 2018 proposals. Under U.S. Chapter 11, any cram down must respect the absolute priority rule. This means that a class can only be subject to cram down where it is paid in full before a more junior class receives anything. U.S. case law has also developed the corollary, namely that a senior class cannot receive more than its claim before a junior class is crammed down. The absence of a rule may provide some flexibility to Plans, for example, it will be easier for a tip to be provided to junior creditors to encourage them to vote in favour, but equally, supplemental fairness criteria are likely to develop as part of the courts' scrutiny.

It is thought that such additional fairness criteria in a Plan context might include:

- the relative sizes of each class in terms of value;
- the degree of support within the dissenting class that the Plan received (for example, if *just less* than 75% within the dissenting class actually approved the Plan, such that the Plan just failed to achieve the statutory majority within that class);

- whether the allocation of value or Plan consideration across classes is fair (e.g. application of surplus value, fees or other value instruments);
- whether any differential treatment between classes with relatively similar rights (but perhaps not so similar that they should be in the same class) is justified;
- whether any differential treatment within the class is justified (e.g. fees, etc.) and how that may impact cram down;
- the impact of cross-holdings on cram down;
- whether the terms to be imposed on the dissenting class are necessary to achieve the survival of the company as a going concern; and
- whether any other class, which is junior to the dissenting class under the Plan, has voted in favour of it.

It is worth noting that in *Re Virgin Atlantic*, a number of the creditor classes approved the Plan unanimously within their class (and by turnout). The court referred to the fact that, in the scheme context, it was not normal practice to include classes in a scheme where 100% of the relevant creditors are known to be willing to consent but that in this case, it appeared that the three fully consenting classes may have been included within the Plan with a view to utilizing the cram down power in the event that the trade creditors did not approve in their class. The court specifically stated that it was not to be taken as deciding whether the power to cram down a dissenting class could be activated in this way, nor whether the inclusion of such a class should be taken into account as a matter of discretion when considering the application of the cram down provisions. This demonstrates that the court will be willing to review the application of cram down (i.e. it is not simply a matter of pure compliance with the conditions set out in section 901G CA) and that it will be ready to review how the classes have been constituted and their potential impact on the application of cram down.

MORATORIUM VETO

Creditors, in respect of moratorium or pre-moratorium debts without a payment holiday under a Moratorium (see our previous note on CIGA and the section "A *new Standalone Moratorium—Payment holiday—but not for all debts*") which has ended less than 12 weeks before an application is made to the court to propose a Plan, will have an effective veto over the Plan since the court cannot sanction a Plan that includes provision in respect of these creditors who have not agreed to it. Inevitably, this will likely result in any court application for a Plan that is proposed following a Moratorium being delayed until after the expiry of this 12-week period.

Similar changes have been made in relation to schemes, so any such veto will apply in relation to any scheme proposal as well.

PENSIONS

Where the company has a defined benefit pension scheme, notice of any Plan must be given to the Pensions Regulator and PPF (irrespective of whether they are a creditor convened to vote on the Plan). Regulations may be made requiring any pension scheme trustee vote on a Plan to be cast by the PPF.

OPINION

The Plan has had its best possible entry into the arena of financial restructuring by helping to safeguard Virgin Atlantic from insolvency. While the Virgin Atlantic Plan saw overwhelming support from its creditors, it will be interesting to see how cross-class cram down (or indeed, cram up) is tested in the future.

Shearman & Sterling remain at the cutting edge of the U.S. and European restructuring markets. We are committed to bringing practical solutions to the issues that our clients face in distressed scenarios, utilising the latest in restructuring tools and techniques.

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