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Alert | Restructuring & Bankruptcy

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Corporate Restructuring in the UK – the Old or the New?

An analysis of the UK's corporate rescue tools: The Company Voluntary Arrangement, the Scheme of Arrangement and the Restructuring Plan.

When it comes to options for the rescue of a distressed UK corporate, there had for a very long time been a growing mood of regret amongst practitioners that there was no comprehensive restructuring tool. That all changed with the introduction of the Restructuring Plan (**RP**).

But, as with all things new, the inevitable question is: what happens to the old?

Will the UK's longstanding corporate rescue tools, the Company Voluntary Arrangement (**CVAs**) and the Scheme of Arrangement (**Schemes**), slip quietly out the back door? Or, more likely, do they remain very useful tools?

We consider here both the old and the new procedures of the UK corporate rescue toolkit and offer some brief thoughts on how and when they may be used over the coming years.

The Old

Historically, two tools have been widely used under UK law to facilitate an 'upstream' corporate restructuring (that is, one where there are signs of distress but insolvency may yet be staved off):

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1. CVAs under the Insolvency Act 1986[1]; and
2. Schemes under the Companies Act 2006[2].

However, both procedures have at times attracted criticism as not always being fit for purpose or as missing certain key functions when compared, for example, to Chapter 11 proceedings in the United States (**Chapter 11**).

- **Schemes**

Conceived as an inherently solvent process, Schemes are not an insolvency procedure as such, but rather have been molded through widespread practice to effect complex corporate restructurings in an often (but not always) distressed context. In many ways, this has significantly contributed to the successful development of the Scheme as an international restructuring tool in that it is a Companies Act process, not an Insolvency Act procedure, and although it is necessary to apply to court to get the Scheme sanctioned, that is a light touch court process with a relatively short and predictable timeline.

With a ready raft of case-law built up over the last few decades, Schemes are now highly developed, reliable and swift, and are imbued with a significant level of familiarity among practitioners and stakeholders (including, importantly, the UK's judiciary). This has led to the Scheme procedure being viewed as a key tool with which to implement international restructurings and, hand in hand with that development, the English courts have been increasingly rigorous in scrutinising the supporting evidence to ensure consistency and fairness.

However, Schemes have historically been considered as fundamentally lacking in two key regards: 1) the absence of an accompanying moratorium to protect the instigating debtor company from enforcement while it progresses with its restructure; and 2) no provisions for cross-class cram-down through use of a Scheme in isolation.

- **CVAs**

CVAs were introduced under the 1986 Act as a tool which was hoped (in hindsight, perhaps with not an insignificant degree of naivety on the part of the legislators of the time) could be used to effect a quick, cost-effective and easy-to-implement restructure of a company's debt.

Their corresponding statutory footing was therefore, quite deliberately, straightforward and crucially only provided for the compromise of unsecured debts and lacked any inbuilt functionality through which a restructure of equity or secured debt could be executed. Given the shifts in capital structures since introduction of the 1986 Act, with secured debt now a significantly more common and material part of corporate balance sheets than before, that shortcoming has become more and more of a hindrance.

That notwithstanding, in the years since their introduction, CVAs have found particular favour with commercial tenants. Such debtors, having often found themselves stretched too thinly across numerous leasing obligations, have availed themselves of the CVA as a handy tool through which to centrally compromise rent arrears and renegotiate rental obligations owed to their many landlords, including the adjustment of rent going forwards.

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[1] Insolvency Act 1986, Part 1.
[2] Companies Act 2006, Part 26.

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However, the introduction of the Commercial Rent (Coronavirus) Bill (which is currently working its way through the House of Lords) and the corresponding Code of Practice for Commercial Rent Arrears – which aim to encourage and facilitate the resolution of rent arrears accumulated during COVID-19 lockdowns, either under a consensual settlement or, failing that, through a binding arbitration system – could have a marked impact on the demand for CVAs post-COVID-19.

Assuming the proposed arbitration scheme and the Code of Practice work as intended, tenants may have less need to turn to a CVA in the immediate future, particularly given recent estimates from the British Retail Consortium that between 80-90% of their members have already reached agreement on the resolution of their COVID-19 rental arrears.

So, while both Schemes and CVAs have proved of much utility to restructuring practitioners, companies and creditors over the last few decades, neither can be considered a comprehensive restructuring tool. Indeed, it must be recognised that they were never set up with quite the same reach or objectives as Chapter 11, and the above outlined limitations must be appreciated within that context.

The absence of a one-stop-shop tool, though, has for some time been a source of much frustration and has led to the frequent practice of running the UK's existing tools in tandem with other procedures, including administration appointments and sales processes, to ensure the comprehensive implementation of a multi-faceted restructuring. Naturally, such an approach has at times been clunky, costly and time-consuming. Mechanical steps, and in particular the transfers of assets and businesses in an accompanying administration, have often been required where they might otherwise have been avoided.

The New

It was with some enthusiasm, then, that the UK's restructuring community received confirmation that the government, as part of its legislative response to the COVID-19 pandemic, would introduce a new, alternative rescue procedure, which had been on the stocks and under consideration for some time: the RP[3].

The RP came into force on 26 June 2020 and built largely on the lessons learned since the introduction of CVAs under the 1986 Act and from the exhaustive judicial consideration of Schemes. It is designed and intended for use as a fully comprehensive corporate rescue tool. Its strength emanates from its far greater efficiency for those creditors with a genuine economic interest in the restructuring of a company, through two key elements:

- **Cross-Class Cram-Down**

The much lauded 'cross-class cram-down' function provides that only those creditors that are 'in the money' (i.e. those who can expect at least some return through the relevant alternative) can block a proposed RP. That means fewer wasted costs fighting uphill battles to persuade creditors and stakeholders of the merits of a proposal where those parties either have no genuine economic interest in the company or would in any event be worse off under the relevant alternative to the RP. There is thus no need to leave the out of the money stakeholders behind by way of an administration pre-pack sale (which, absent being able to persuade out of the money creditors to fold their hands, has historically been required).

[3] Companies Act, Part 26A.

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This powerful new mechanism comes with safeguards, however. There is a significant onus on those proposing the RP to demonstrate that they have adequately considered the interests of all impacted parties, and the right balance must be struck to ensure that no creditor is worse off than it would be in the relevant alternative. Failure to address such factors will risk the court exercising its discretionary power to intervene and block the plan on behalf of those being crammed (explored in more detail below).

With cross-class cram-down having already been successfully utilised in *Deep Ocean*[4], *Virgin Active*[5], and *Amicus Finance*[6] (but unsuccessfully in *Hurricane Energy*[7]), the recently reported landmark convening decision in Smile Telecoms'[8] second RP has paved the way for even more efficient restructurings via an RP. In *Smile*, the court determined it was competent, under section 901C(4) of the Companies Act, to exclude from voting on a plan those classes of creditor who have no genuine economic interest in the company (i.e. no prospect of any recovery via either the RP or the relevant alternative). For a more detailed discussion of the decision in *Smile*, please see our GT Alert here.

This option under the RP legislation was used to facilitate a streamlined approach of seeking only the approving vote of only one of the eight classes of creditors and members. The "out of the money" stakeholders (i.e. those with no genuine economic interest) were deprived of a class meeting which in this respect aligns the RP procedure to the US Chapter 11 process, which deems a completely out of the money creditor to have rejected the plan, but they do not get to vote on the plan and so have no right of veto over the Chapter 11 plan.

- **Judicial (and Regulatory) Scrutiny**

Unlike CVAs, which are not initially subjected to the judicial scrutiny of the courts, RPs (and Schemes) require significant but focused court involvement at two hearings ('convening' and 'sanction').

While this higher degree of court scrutiny at the outset may lead to increased costs up front, it has and should continue to inspire greater confidence that the restructuring will not be de-railed by challenge down the line, which, in turn, should generally lead to more cost confidence and certainty of outcome.

It should also be noted that regulators, as well as the courts, are starting to exert increasing pressure and scrutiny on both RPs and Schemes, particularly where consumers are impacted, e.g. the recent decision on the proposed Amigo Loans[9] scheme, where the court was impacted by (among other considerations) the FCA's intervention on behalf of consumer creditors.

In Amigo, the FCA appeared at the sanction hearing and opposed the proposed Scheme on fairness grounds due to the low level of consideration offered to the scheme creditors (i.e. the consumers), which the FCA argued unfairly benefited other stakeholders such as shareholders and bondholders who were making an "inadequate contribution" to the restructuring.

Following that intervention – which marked a step-change when compared to a more lackluster approach just months earlier in the case of Provident SPV Limited[10] – the FCA has taken steps to clarify how it sees

[4] *Re DeepOcean 1 UK Ltd and other companies* [2021] EWHC 138 (Ch).
[5] *Re Virgin Active Holdings Ltd and other companies* [2021] EWHC 1246 (Ch).
[6] *Re Amicus Finance plc (in administration)* [2021] EWHC 3036 (Ch).
[7] *Re Hurricane Energy plc* [2021] EWHC 1759 (Ch), [2021] All ER (D) 48 (Jul).
[8] Greenberg Traurig, LLP acted for the senior secured creditor.
[9] *Re All Scheme Limited* [2021] EWHC 1401 (Ch).
[10] *Re Provident SPV Limited* [2021] EWCH 2217 (Ch).

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its role in restructurings going forward and has warned regulated companies that it will formally object to debt compromises which it considers do not "treat… customers fairly".[11]

Old vs New

As we move further into 2022, it remains to be seen whether it will be the old or the new tools that prove of greatest utility in dealing with what could amount to a surge of post-COVID-19 restructurings, as government support and creditor forbearance tails off. Likely, the choice of restructuring tool (or indeed arbitration if the matter concerns unpaid rent between 21 March 2020 to 18 July 2021 due to the adverse effect of COVID-19) will depend on the facts of each situation.

- **CVAs**

It seems probable that CVAs will continue to remain favourites when it comes to the compromising of commercial rents, given their specific treatment of unsecured debt and their now well-established line of case law.

Further, prospective CVAs may well find encouragement in the recent introduction of industry standard models[12] and the support they may expect from secured high street lenders and HMRC, both of whom remain acutely aware of sensitivities (particularly post-COVID-19) around their roles in promoting the recovery of viable businesses. While there will inevitably be some instances in which their intervention and enforcement can be expected, the broader approach may be more measured and supportive, with the directors of struggling businesses being urged to take remedial steps themselves: neither the banks nor the tax man are keen to have their fingerprints on too many post-COVID-19 insolvencies (with banks in particular understandably looking to avoid any repeat of negative media exposure regarding the historic roles of their business support functions).

- **Schemes**

Schemes, despite their inherent flexibility and suitability to solvent as well as distressed situations, and the ready familiarity they have come to enjoy in the market, are likely to be less frequently used than before.

Having said that, they should continue to be a powerful force in certain situations, including where the intention is to restructure a single or limited number of classes of stakeholder and there is broad support in those classes to do that: unlike RPs, a Scheme restructuring does not have to consider the entirety of a debtor's balance sheet.

So, for example, Schemes can be used to compromise financial debt claims or specific classes of consumer claims, such as mis-selling (as has been attempted recently in the proposed Schemes for Card Protection Plan Limited[13] and Provident SPV Limited[14] (successfully) and Amigo Loans[15] (unsuccessfully, so far)).

- **Schemes v RPs – the Role of Recognition**

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[11] The FCA has commenced a consultation on its proposed guidance in respect of its approach to debt compromises for regulated firms – GC22/1, which is publicly available online via the FCA's website for review and comment, with a deadline for responses set for March 2022.
[12] R3, the association of insolvency and restructuring professionals, recently published a model aimed at SME companies seeking a debt compromise post-COVID-19. The model is publicly available online via R3's website.
[13] *Card Protection Plan Limited, Re* [2014] EWHC 114 (Ch).
[14] See FN 10 above.
[15] See FN 9 above.

It is significant that RPs have been determined by the High Court (in Re. gategroup Guarantee Ltd[16]) to be 'insolvency proceedings'. That determination, while made specifically in the context of the Lugano Convention's bankruptcy exclusion (which operates to exclude bankruptcy processes from recognition under that treaty), is expected to have a much wider adverse impact on the international recognition of RPs (which is already a trickier proposition post-Brexit).

RPs seeking recognition in a foreign jurisdiction will therefore not be able to rely on Lugano (or, most likely, the Hague Convention), and instead will have to rely on far narrower and more involved routes to recognition, including local law considerations.

Schemes, on the other hand, do not appear to have been tarred with the same 'insolvency proceedings' brush and so may be the more popular option where a restructure requires some degree of cross-border recognition (although it should be noted that the Lugano Convention route also remains closed for Schemes post-Brexit, with the EU having blocked the UK's accession to that treaty).

Conclusion

RPs have taken UK restructuring to the next level.

For many complex restructurings, the mood of the market suggests that we will continue to see a steady uptick in the use of RPs in place of the old tools, as stakeholders look to capitalise on the comprehensive and efficient restructuring solutions now offered by this long-awaited UK process.

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[16] *Re gategroup Guarantee Limited* [2021] EWHC 304 (Ch)

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