Case: In the matter of Virgin Active Holdings Limited & others [2021] EWHC 814 (Ch) (convening judgment, 1 April 2021), [2021] EWHC 1246 (Ch) (sanction judgment, 12 May 2021) and [2021] EWHC 911 (interim costs judgment, 16 April 2021), Snowden J.

Synopsis: Snowden J sanctioned three parallel restructuring plans notwithstanding that certain landlord classes had not approved the plans and certain landlords actively opposed sanction. Since the dissenting lower-ranking classes would be out of the money in the relevant alternative, the court attached little weight to their objections.

Topics covered: **Restucturing plans; class constitution; cross-class cram-down; valuation; disclosure; costs**

Comment

These were the first fully-opposed restructuring plans, following an extensive five-day sanction hearing, and the first to compromise multiple classes of landlords. Snowden J's 72-page sanction judgment provides significant guidance as to the court's approach to sanctioning a restructuring plan that not every class has approved.

By reference to the long-established stakeholder hierarchy in insolvency, and Parliament's intentions in introducing the new restructuring plan procedure, it is clear that the votes of out-of-the-money classes (and their views as to the appropriate distribution of post-restructuring rights) are likely to be given little to no weight by the court — unless they produce credible evidence that they are not in fact out of the money in the relevant alternative.

Core takeaways include:

on valuation:

- the court will be concerned not to permit lengthy valuation disputes, to avoid undermining the utility of the restructuring plan procedure (whilst preserving creditor protections)
- the court conducted a thorough analysis of the plan companies' valuation evidence, opposed by an ad hoc group of landlords — one of only a handful of cases in which the English courts have had to analyse distressed valuations in this way
- there is no absolute obligation to conduct a market testing process
- absent competing valuation evidence from the opposing landlords, the court could not do anything other than assess the restructuring plans on the basis of the evidence before it

on matters of discretion:

- since the dissenting lower-ranking classes would be out of the money in the relevant alternative to the restructuring plans, the court attached little weight to

either the numerical opposition to the plans in those classes (absent any evidence explaining why they had voted against the plans) or to opposing landlords' objections as to what the secured creditors had agreed with the plan companies as to the share of the post-restructuring equity
- instead, it is essentially for those creditors who are "in the money" to determine how to divide up any value or potential future benefits that use of the business and assets might generate post-restructuring

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The Facts

Virgin Active's restructuring comprised three parallel restructuring plans.

1 Secured Creditors

• Key terms: No haircut; three-year extension to maturity; Various amendments to the senior facilities agreement

• Approval by value, of those voting: 100% in each of the three plans

2 Landlords

• Key terms: Divided into five classes, certain of which were substantively unimpaired, certain of which switched to reduced rent for a set period of time, and certain of which switched to zero rent under the plans, in return for payment of 120% of the estimated outcome in the administration alternative; The plans included "break rights" for landlords in Classes C to E (i.e. the classes there were most substantially impaired) to take back and re-let their properties

• Approval by value, of those voting: voting varied between plan companies:

- Class A: 99–100%
- Class B: 19–45%
- Class C: 0–67%
- Class D: 0%
- Class E: 0–8%

3 Other unsecured creditors

• Key terms; Claims of certain unsecured "general property creditors" compromised in return for payment of 120% of the estimated outcome in the administration alternative

• Approval by value, of those voting: voting varied between plan companies: 0–7%

4 Shareholders

• Key terms; Not included within, or compromised by, the restructuring plans; Package of support from shareholders/affiliates, including capitalisation of intercompany liabilities, waiver of licence fees, provision of £45 million new money by way of loans (pre- and post-implementation) and up to £6 million of equity

As noted, certain landlords opposed the plans at both convening and sanction stages, on various grounds explored below.

The Decision

Convening judgment

Threshold conditions: The court was readily satisfied that the threshold conditions under s901A CA 2006 were satisfied.

Class composition: The court was satisfied as to the plan companies' proposed class composition, under which landlords with similar existing rights but whose rights would be varied differently under the plans (reflecting the perceived economic and strategic value of the relevant lease) would be placed into five different categories ([78-80] of the convening judgment). This methodology is familiar in the context of landlord company voluntary arrangements but had not previously been used in the context of a restructuring plan.

Differences in the guarantee package for each lease did not fracture the classes further ([81-83] of the convening judgment). Nor did the fact that certain general property creditors had claims for crystallised and/or accrued arrears warrant a separate class to the other general property creditors, most of whose claims were only contingent ([85-88] of the convening judgment).

The court noted that, whilst the counterfactual comparator (for the purpose of determining class composition at the convening hearing) and the relevant alternative (for the purposes of any cram-down argument at the sanction hearing) are clearly equivalent concepts, in practice, there might be a difference between evidence available to the court at those two stages ([69] of the convening judgment).

Explanatory statement: The ad hoc group of landlords, opposing, contended that the plan companies should disclose certain additional information in the explanatory statement, or otherwise make it available - namely, an entity priority model prepared by Deloitte; the group's latest five year business plan; the group's full 13-week and 12-month cash-flow forecasts; the group's historical financial statements, including full monthly management accounts, broken down site-by-side for 2019, 2020 and Q1 2021, among other items.

The court was not satisfied that such information was so essential that it should manifestly be included in the explanatory statement. The court noted the entity priority model was the property of Deloitte and held it would suffice that Deloitte would be available to answer queries on it from professional advisers to plan creditors ([115] of the convening judgment). The court accepted that certain information, such as the five year business plan, cash-flow forecasts and historical financial information, was commercially confidential. To require it to be included in the explanatory statement would amount to ordering its unrestricted disclosure.
Instead, the court indicated that the plan companies ought to make disclosure of certain information on the basis of confidentiality undertakings being given to the court by (named) lawyers and accountancy advisers to the ad hoc group of landlords and any other plan creditor intending to appear at the sanction hearing ([125-129] of the convening judgment).

Sanction judgment

In a landmark judgment, the English court sanctioned Virgin Active's restructuring plans, notwithstanding a major challenge by certain landlords. Given not all classes had approved the plans, three questions arose for the court's consideration:

1 If the restructuring plans were sanctioned, would any member of a dissenting class be any worse off than they would be in the event of the relevant alternative? i.e. the "no worse off" test - "Condition A" in s901G CA 2006.

2 Had each restructuring plan been approved by at least 75% of those voting in any class that would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative? - "Condition B" in s901G CA 2006.

3 In all the circumstances, should the court exercise its discretion to sanction the restructuring plans?

There was no dispute as to whether the second question was satisfied, given the secured creditors' class had approved the plans.

"No worse off" test

The court noted that determining whether this test is satisfied is an inherently uncertain exercise, given the court must consider a hypothetical comparator, based on assumptions and possibly subject to contingencies ([108] of the sanction judgment).

The court held:

- when determining the relevant alternative, the question for the court was "what is the relevant alternative now if the plans are not sanctioned?" ([115] of the sanction judgment); it was not necessary to consider whether the plan companies might have acted differently or explored other options, or whether the way in which the restructuring and the plans were negotiated was in some way unfair to other creditors; however, the court would consider such points when deciding whether to exercise its discretion to sanction the plans;

- the most likely relevant alternative to Virgin Active's restructuring plans was a trading administration, involving the accelerated sale of the most valuable parts of the plan companies' businesses;

- "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" ([130] of the sanction judgment);

- there is no absolute obligation to conduct a market testing process as part of a restructuring; rather, the question is whether it was necessary or practicable in the circumstances of the case (including by reference to whether such an exercise would be likely to have resulted in a materially more reliable valuation than that actually undertaken) ([139-140] of the sanction judgment);

- the fruits of any market testing exercise in this case would have to be treated with extreme caution, given it would have involved offering gym and leisure businesses for sale during a time of prolonged closure owing to Covid-19 restrictions — i.e., "the market into which such testing would have been done could hardly have been less favourable" ([145] of the sanction judgment);

- the valuations and calculations in the plan companies' evidence appeared to be reasonable and capable of being relied upon for the purposes of determining whether to sanction the plans;

- if any landlord genuinely believed they could obtain a demonstrably better deal than in the relevant alternative, they had had ample opportunity to adduce evidence to that effect (and had not done so); and

• based on the evidence, each dissenting class of plan creditor would be no worse off under the plans than in the relevant alternative.

Accordingly, the "no worse off" test was satisfied.

Exercise of discretion

Part 26A gives little guidance on the factors that are relevant when the court is exercising its discretion to sanction a restructuring plan that not all classes have approved. The court made the following comments regarding the exercise of its discretion in such a scenario:

• there is no more justification under Part 26A than in relation to Part 26 for the court simply to impose its own views of what is or is not "fair" or "just and equitable" ([221] of the sanction judgment);

• "*whilst a rationality test can be applied when considering whether to sanction a scheme under Part 26 which has been approved by a majority in each relevant class, the same test cannot necessarily be applied in the same way when the court is considering whether to exercise the power under section 901G to sanction a Part 26A plan against the views expressed by a dissenting class*" ([222] of the sanction judgment);

• "*one should be careful not to read too much into Trower J's comments in [Re DeepOcean 1 UK Limited [2021] EWHC 138 (Ch)] (i) that a plan company that satisfies Conditions A and B in section 901G "will have a fair wind behind it", and (ii) that "all other things being equal, satisfaction of conditions A and B is capable of justifying an override of the views of a dissenting class". Trower J expressed these views in cautious terms – i.e., a "fair wind" and "capable" of justifying, and he added the important caveat of "all other things being equal". He was certainly not saying that satisfaction of Conditions A and B would, of themselves, be sufficient in all cases*"; rather, the court will take a series of factors into account ([223-225] of the sanction judgment);

• conceptually, a restructuring plan may give different treatment and substantial value to some, but not all, creditors who are out of the money (citing DeepOcean) ([260] of the sanction judgment);

• since the opposing landlords would be out of the money in the relevant alternative, the court attached little weight to the numerical opposition to the plans in the lower-ranking classes (absent any evidence explaining why they had voted against the plans);

• for the same reason, opposing landlords' objections to what the secured creditors had agreed with the plan companies as to the share of the "restructuring surplus" (i.e., the value preserved or created by the restructuring) carried no weight ([242-258] of the sanction judgment);
instead, it is for those creditors who are "in the money" to determine how to divide up any value or potential future benefits that use of the business and assets might generate post-restructuring;

• if there had been no secured creditors and the battle on sanction had been between assenting Class A landlords vs. dissenting landlord classes (where each class would have been "in the money" in the relevant alternative), the court might well have to look closely at whether the proposed compromise with the assenting class was a real "compromise or arrangement", or a manipulation of the classes, and whether the dissenting class(es) received a share of the "restructuring surplus" that was proportionate or comparable to the compromise they were being asked to make; in addition, the court would want to fully understand the benefits to be conferred on shareholders had this been at the expense of creditors who were "in the money" ([255] of the sanction judgment);

• the differential treatment between landlord classes was explained by reference to the profitability and commercial importance that the plan companies attached to the relevant clubs ([265] of the sanction judgment);

- there was nothing inappropriate in choosing to use a restructuring plan rather than a company voluntary arrangement (where the evidence indicated a company voluntary arrangement was likely to be blocked by the landlords' votes) ([276] of the sanction judgment);

- the retention of equity by the shareholders was predicated on substantial "new value" offered by the shareholders (which the court distinguished from the waiver of existing liabilities) ([282 and 293-297] of the sanction judgment - including consideration of U.S. Chapter 11 cases on "new value" at [287-292]); and

- the court accepted evidence that the new money lent by the shareholders could not have been obtained on the same or better terms from any other source in the market ([297] of the sanction judgment).

Interim costs judgment

Following an interim costs hearing (after the convening hearing but before the sanction hearing), the court accepted the plan companies' submission that it should reserve the question of parties' costs until after the sanction hearing.

However, the interim costs judgment includes a helpful summary of costs principles in relation to scheme cases under Part 26 of the Companies Act 2006 ([29] of the interim costs judgment). Norris J has since stated that Snowden J's "careful summary is now the starting point for deciding costs issues in relation to members or creditors schemes" (In the Matter of William Hill PLC [2021] EWHC 1347 (Ch) at [3], in the context of a members scheme).

The court accepted the plan companies' submission that - in conventional scheme cases - there is not a principle for the payment of the costs of opposing creditors; rather, the court's discretion is more open-ended, highly fact-sensitive and will be exercised on a case-by-case basis in light of all the circumstances.

The court expressly noted that it had not determined that the end point of the analysis in relation to costs under Part 26A would necessarily be the same as under Part 26 ([30] of the interim costs judgment).

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