A flying start for the restructuring plan

Alex Rogan looks at the maiden flight of the restructuring plan, highlighting the practical considerations for future cases.

Over the summer, the court sanctioned Virgin Atlantic's restructuring plan for take-off, making this the first restructuring to be implemented through the new restructuring plan introduced by the Corporate Insolvency and Governance Act 2020 (CIGA) in June 2020. The judgments from both the convening and sanction hearings provide practical guidance on how the court will treat this shiny new tool and, in particular, comfort that its scheme of arrangement-like provisions will be approached in a scheme-like way. However, given that the restructuring plan was approved by all classes of creditors, its key shiny new feature, cross-class cram down, was left untested. Unlike a scheme that requires the support of all creditor classes, this cross-class cram down mechanic will allow the court, subject to certain criteria being satisfied, to sanction a restructuring plan where a class or classes of its stakeholders have voted against it. This additional feature is expected to be a game changer for the UK's restructuring toolkit.

Why did Virgin require restructuring?

Before the Covid-19 pandemic Virgin Atlantic's business was fundamentally sound. However, following the pandemic bookings fell 89% year on year, as governments introduced travel restrictions and consumers lost their appetite for air travel, causing an acute liquidity crisis that left the airline just weeks away from running out of cash and potentially facing enforcement proceedings by bondholders. As a result, the most likely alternative outcome – had the restructuring plan not been sanctioned – would have been the airline being put into administration. This would have led to significant loss of value for all stakeholders with unsecured creditor recoveries forecast in the range of 10.5p to 21.4p in the pound.

What was the proposal?

The restructuring plan was part of a broader recapitalisation to enable the airline to continue to trade as a going concern through the reduction of the airline's debt to a sustainable level and an injection of new money amounting to c.£400m. Various parties agreed bilateral arrangements with Virgin Atlantic outside of the restructuring plan as part of its wider recapitalisation, including lessors and lenders whose claims totalled almost $1bn (£753m) under various finance lease agreements, bondholders under an airport slots securitisation and credit card acquirers owed around £350m.

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The restructuring plan itself affected four separate classes of creditor:

- lenders under a $280m secured revolving credit facility;
- lessors under 24 aircraft operating leases;
- certain connected party creditors that had entered into various intellectual property licensing agreements and joint venture agreements; and
- 162 trade creditors owed around £51.7m.

The substance of the plan included:

- converting the revolving credit facility to a term loan with an extended repayment schedule in return for a higher margin and lender-friendly amendments to covenants;
- in respect of the aircraft operating leases, a choice of three options was provided to lessors, all of whom chose the rent deferral option;
- in respect of the connected party creditors, capitalising all accrued and unpaid amounts in exchange for preference shares; and
- a 20% reduction in amounts owed to certain trade creditors.

A large number of trade creditors were excluded and their claims were not reduced or deferred. These included suppliers of goods and services essential to the airline's continued operation, such as airports, public bodies, insurance companies and sales agents, as well as creditors who had already agreed to a larger reduction in outstanding liabilities as of 12 June 2020, creditors owed under £50,000 as of 12 June 2020, and trade creditors that provided restructuring advice in relation to the recapitalisation.

Key takeaways from the Virgin plan

The court gave important clarifications on a number of points, which will allow practitioners to consider the restructuring plan with greater confidence in the future. The key points from both the convening hearing and the sanction hearing are set out below.

Convening hearing

Unlike a scheme of arrangement, which is available to solvent and insolvent companies, the restructuring plan is only available to companies that have encountered, or are likely to encounter, financial difficulties that are affecting (or will or may affect) their ability to carry on business as a going concern (the financial condition) and the compromise or arrangement provided for under the restructuring plan must eliminate, reduce or prevent, or mitigate the effect of, any of those financial difficulties (the purpose condition). The court had no difficulty in finding that the Virgin Atlantic restructuring plan squarely satisfied these two requirements.

One of the key questions for how the restructuring plan will be deployed going forward relates to how the court will approach class constitution. In this regard, the court noted the key differences between the restructuring plan and the scheme, and the fact that in order to effect a cross-class cram down under a restructuring plan, a company may have an incentive to increase the number of classes to ensure that it has the required single supporting class. Nevertheless, the court concluded that these differences should not be reflected in a different approach to class composition and the scheme test for class composition should be applied, namely: stakeholders should vote in the same class where their rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.

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Sanction hearing

The court has discretion to decline to sanction a restructuring plan if it is not 'just and equitable'. However, there is no guidance as to what this standard means and the extent to which it will be similar to the 'fairness' requirement for schemes of arrangement. Following the Virgin restructuring plan it is safe to conclude that in circumstances where all classes have voted in favour and the cross-class cram down mechanic is not being deployed, then the court will approach sanction on a similar basis as it would for a scheme.

The court did, however, note that the Virgin Atlantic restructuring plan had an unusual feature. Three of the four classes of creditors had already agreed to support the restructuring ahead of the convening hearing. In relation to a scheme, the court would not ordinarily entertain an application to convene scheme meetings in these circumstances. It appeared to the court that the three fully consenting classes of creditors had been included with a view to allowing the airline to use the cross-class cram down in the event that the fourth class of creditors, the trade creditors, had not voted in favour of the restructuring plan. The court did not conclude its position on this point and specifically stated that in sanctioning the restructuring plan it should not be taken to have decided that the power to cram down a dissenting class can be activated by including within a plan a class of creditors who had unanimously consented ahead of the convening hearing. This will be a key point to resolve going forward, which will impact on the utility of the restructuring plan and how it is deployed.

Another interesting aspect of the Virgin restructuring plan that was considered at the sanction hearing related to the fairness of certain trade creditors being paid in full while other trade creditors subject to the plan faced a 20% reduction in what they were owed. The court held that the ability of a company to choose to restructure the debts of some of its creditors and not others is one of the most flexible and valuable features of the scheme jurisdiction and that this approach was equally appropriate for the restructuring plan. The important point is to ensure that where creditors, who rank pari passu with scheme or plan creditors, are being treated more favourably outside the scheme or plan, this should be fully explained so that compromised creditors are in a position to assess whether they are being treated unfairly. In this instance, the court held that the reasons for excluding certain trade creditors from the restructuring plan were reasonable (ie not arbitrary or designed to manipulate the class) and had been disclosed to creditors in the explanatory statement.

Ipso facto clause protection

An additional noteworthy element to the restructuring plan over the scheme is the application of the new prohibition on enforcing ipso-facto clauses, which was introduced under CIGA. This allows for debtors, such as was the case for Virgin Atlantic, to implement operational as well as financial restructurings through the restructuring plan with less execution risk around trade creditors terminating contracts.

Concluding thoughts

Perhaps the overarching conclusion of the Virgin Atlantic restructuring is that the courts will treat the restructuring plan in a similar manner to the scheme. This brings a considerable amount of certainty to the use of this valuable new tool. Although the cross-class cram down was not deployed, its availability allowed the restructuring to be significantly de-risked by mitigating the ability of the trade creditor class to potentially derail the restructuring should they have elected not to support the restructuring plan.

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Following on from the Virgin Atlantic restructuring, Pizza Express recently implemented its long-running financial restructuring through a restructuring plan, in which it also managed to secure the support of each stakeholder class and did not need to rely on the cross-class cram down. As such, the market still eagerly awaits the first deployment of the cross-class cram down mechanic to go before the courts.

In a scheme, provided all stakeholders receive adequate information with sufficient time to make an informed decision, and there is no evidence stakeholders are voting for reasons not related to their class interest, the court is slow to second guess a majority decision of the scheme meetings. However, the court will potentially be required to take a more activist approach in the restructuring plan process, and determine difficult issues of valuation and how value is allocated to different stakeholder groups where there is a cross-class cram down. The restructuring plan is notable for not having an absolute priority rule, in the vein of the US Chapter 11 rule, which addresses this value allocation point. This rule provides that no lower-ranking class of stakeholder can receive any payment under a restructuring proposal subject to a cross-class cram down unless all higher-ranking classes are first paid in full. We will have to wait and see whether the courts develop a form of the absolute priority rule as they are asked to sanction restructuring plans with a cross-class cram down. ◻

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