Virgin Active, Hurricane Energy and the future of the cross-class cramdown

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Speed read

- The UK restructuring plan, first introduced in June 2020, is a tool that can be used to bind dissenting creditors and/or shareholders into a restructuring. We are now starting to see this tool used in practice.
- Allen & Overy advised Virgin Atlantic Airways on the first-ever successful restructuring plan, and **Virgin Active on one of the earliest successful cross-class cramdown restructuring plans.**
- The English court has recently **refused to sanction the Hurricane Energy restructuring plan.** This is the first time the English court has refused sanction of a cross-class cramdown plan.
- Stakeholders should continue to see the restructuring plan as an important tool for the implementation of complex restructurings.

Please get in touch with any of the contacts listed at the beginning of this alert should you have any questions.

Introduction

The UK restructuring plan (the **plan**), introduced by the Corporate Insolvency and Governance Act 2020 into Part 26A of the Companies Act 2006, is a recent addition to the cross-border and domestic restructuring toolkit. Based on the UK scheme of arrangement, the plan super-charges the scheme by providing distressed companies with a mechanism under English law to bind dissenting classes of creditors or shareholders into a restructuring (often referred to as a **cross-class cramdown**) through the English courts.

The wealth of scheme precedent guides our interpretation of the law behind the new plan. However, the introduction of the cross-class cramdown is a clear departure from scheme precedent. Historically, the courts have indicated that they would be slow to differ from the decision of the majority creditor vote in support of a scheme. The plan, with the ability to deprive certain stakeholders of a veto right that they might have otherwise had under a scheme, has raised questions as to whether the court will take a new approach when asked to exercise its discretion and sanction a plan.

We are starting to see the use of the plan, including the cross-class cramdown, in practice. Allen & Overy advised Virgin Atlantic Airways on the first-ever successful restructuring plan and **Virgin Active on one of the earliest successful cross-class cramdown plans**. Subsequent to those cases, the court recently refused to sanction Hurricane Energy's cross-class cramdown plan. This alert reflects on the use of the cross-class cramdown, and the future of the plan, by reference to the recent Virgin Active and Hurricane Energy judgements.

The judgements handed down in each of these cases are well-reasoned and thorough, and provide insight into the court's perspective on a number of issues beyond those considered in this alert.

Background to the Virgin Active and Hurricane Energy plans

Virgin Active

Virgin Active, the international health club operator, saw its revenues reduce dramatically during the Covid-19 pandemic. Despite the group taking actions to mitigate its liquidity issues, by early 2021 the group had concluded that it was facing an impending liquidity crisis. With that burning platform, it was anticipated that the group would fall into a formal insolvency process in the absence of a restructuring. To avoid insolvency, Virgin Active proposed three parallel plans in March 2021. The plans received the support of the company's senior creditors and certain landlords, but were opposed in court by an ad hoc group of landlords.

Hurricane Energy

Hurricane Energy plc, an AIM-listed company, is a part of a group that hold licences in relation to the exploration and extraction of oil in the UK Continental Shelf. Hurricane funded its operations through a number of equity raises and the issue of USD230 million unsecured convertible bonds. The company currently has only one well with any current or planned oil production (known as the "P6" well in the "Lancaster" field). In late 2020, following a technical review of the Lancaster field, the company significantly reduced its estimate of proven probable oil reserves. The company came to the view that, while it could continue to trade in the short to medium term, it would be unable to repay its bonds in full at maturity in July 2022. In April 2021, the company proposed a plan following negotiations with an ad hoc group of its bondholders.

Following the launch of the plan, Crystal Amber (a c.15% shareholder) requisitioned an emergency general meeting for the purpose of replacing certain directors on the company's board. Crystal Amber also opposed the plan in court, alongside other individual shareholders.

The headline restructuring terms and voting on the plans

The headline commercial terms proposed in each of the Virgin Active and Hurricane Energy plans, and the voting outcomes of each class of creditors and shareholders (as applicable) affected by each plan, are briefly summarised at the end of this alert.

Cross-class cramdown, the relevant alternative and the court's discretion

Conditions to the cross-class cramdown

At least one class voted against each of the Virgin Active and Hurricane Energy plans. As such, the company in each case had to ask the court to exercise its discretion to sanction the plan and cram those dissenting classes into the restructuring. Whether or not the court can sanction a plan using a cross-class cramdown depends on the court's assessment of the following conditions:

- **Condition A:** that none of the members of the dissenting class would be any worse off under the plan than they would be in the event of the "relevant alternative" (which is whatever the court considers would be most likely to occur in relation to the company if the plan were not sanctioned); and
- **Condition B:** that at least one class of creditors or shareholders has voted in favour of the plan, provided that class would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative (in each of the Virgin Active and Hurricane Energy plans, this Condition B was clearly satisfied by the most senior class of creditor voting in favour of the plan(s)).
- **The court's discretion:** In addition to Condition A and B, the court will consider whether, in all the circumstances, it should exercise its discretion to sanction the plan.

As anticipated when the plan was first passed into law, the question of "what is the relevant alternative?", and whether or not the court should exercise its discretion to impose a plan on a dissenting class, has led to fierce differences of opinion between proponents and opponents of a plan. In the sanction hearings for Virgin Active and Hurricane Energy, these differences of opinion were heard in detail and over several days.

Virgin Active

- **The company's submissions:** the relevant alternative to the plans would have been an administration followed by an accelerated sale. This was on the basis that if the plans were not sanctioned by the court, the group was forecast to run out of cash imminently thereafter.
- **The opposing view:** the ad hoc group of landlords that opposed the plans did not materially challenge the company's submission that the most likely alternative to the plans was an administration followed by an accelerated sale. However, the landlords raised a number of points relating to the court's discretion to sanction the plans, focussing on:
  - the company's valuation evidence, in particular that the valuations were insufficient as they were not supported by market testing;
  - the provision to creditors of information relating to the plans; and
  - whether the court should exercise its discretion in circumstances where more junior stakeholders (specifically, the existing shareholders) were retaining their interests in the group at the "expense" of more senior creditors (the dissenting landlords).
- **Key takeaways:**
  - The court sanctioned the Virgin Active plans.
  - The court considered the company's valuation evidence at length, providing reasoned insight into the court's approach when appraising valuations in a restructuring scenario.
  - An application for cross-class cramdown may require the court to look closely at the exercise of its discretion and, in this case, the question of whether differences in treatment between classes of stakeholder are justified (referred to as the "horizontal comparison"). The court considered this in the context of the landlord's complaints that the existing shareholders, as more junior stakeholders, were receiving different treatment under the restructuring.
  - The court found that the dissenting landlords were "out of the money" in the relevant alternative. Consequently, the court gave little weight to their objections and deferred to the senior "in the money" creditors as to how they might allocate any value/upside in the group to the out of the money classes following the restructuring.

Hurricane Energy

– **The company's submissions:**

  – The relevant alternative would have been a "controlled wind-down". The company would likely continue to trade until May 2022 (two months prior to the final maturity date of the company's unsecured bonds) and then commence a decommissioning process of the oil field.

  – During the hearing, the company also submitted that in the event the plan was not sanctioned and the board of Hurricane Energy replaced (at the extraordinary general meeting requisitioned by Crystal Amber), the new board may pursue risky strategies that could result in the insolvent liquidation of the company.

– **The opposing view:** Crystal Amber, the key opposing shareholder, argued that the premise of the controlled wind-down, with the company ceasing to trade two months before the final maturity of the unsecured bonds, was flawed. The company was forecast to continue trading profitably in the short and medium term, and there remained a realistic prospect that one of a number of options may be open to the company over the course of the next year to remove/refinance the unsecured bonds by their scheduled maturity date.

– **Key takeaways:**

  – The court refused to sanction the plan on the basis that the "no worse off test" in Condition A had not been satisfied. As a result, the court did not need to exercise its general discretion to sanction the plan – though the court would have refused to exercise that discretion if necessary. This decision may be subject to appeal.

  – The court found that it was common ground from the company's and the opposing shareholder's submissions that, if the plan were not sanctioned, the company would most likely continue to trade profitably (in the short to medium term). The court did not accept the company's position that the appointment of a new board (in the absence of the plan) would most likely lead to a near-term insolvent liquidation of the company.

  – There was no burning platform, and the relevant alternative was not an immediate liquidity crisis or insolvency. With the prospect of the company continuing to trade profitably and the amount of time before the maturity of the unsecured bonds, the court was willing to consider potential alternatives to the plan that could be developed and pursued by the company to resolve its anticipated financial difficulties.

  – The court commented that the burden lay with the company, as the proponent of the plan, to show that the shareholders would not be any better off if they retained their existing rights and the company continued to trade for at least another year. The court found that the company had failed to meet this evidential burden based on the specific fact-pattern. The court felt that, by retaining all of the equity in a company that continues to trade, the shareholders would be better off than being compromised now under the plan.

What does this mean for the future?

The Hurricane Energy sanction judgement was the first time the court has refused to sanction a cross-class cramdown plan. Inevitably, the Hurricane Energy judgement has resulted in some dramatic headlines in the restructuring press. Some of those headlines question the future of the plan.

Following our work advising Virgin Active in relation to its successful plans, and having considered the written judgements of Zacaroli J. in relation to the Hurricane Energy plan, we remain of the view that the plan will be an important tool for implementing complex restructurings going forward. It should be unsurprising that the introduction of a cross-class cramdown procedure into English law has led to fiercely contested court hearings, as well as the court reflecting on its discretion when asked to sanction a plan. After all, there is a distinction between binding a minority vote into a restructuring where the relevant stakeholders are voting in the same class (as is the case under a scheme) and depriving an entire class of stakeholders of their right to veto a restructuring (as is the case under a cross-class cramdown plan). It is also clear from the legislation that the court has a key role to play in determining whether or not a cross-class cramdown should be sanctioned. The thorough and well-reasoned judgements of Snowden J. and Zacaroli J. in respect of the Virgin Active and Hurricane Energy plans (respectively) provide insight into how the court might react to future cross-class cramdown plans.

The headline restructuring terms and voting on the plans

Virgin Active: headline restructuring terms and voting on the plans		
Creditor group	**Headline terms**	**Plan meeting results**
Secured Creditors	Various amendments to the senior facilities agreement, including a maturity date extension No reduction in principal amount outstanding.	Passed
Landlords	Landlords split by site into five classes: class A, B, C, D and E. Determination of classes made by reference to certain criteria, including operating margin of each site. Treatment of accrued rent and go-forward rent under the plans was dependent on the class of site. For example, landlords of class A sites saw their claims (largely) unimpaired, while landlords of class E sites saw rent arrears written off in full and a permanent 100% rent reduction. The plans included break rights (and an associated payment) for landlords in classes C, D and E.	Class A – Passed Class B – Rejected Class C – Rejected Class D – Rejected Class E – Rejected
General Property Creditors	Claims discharged in exchange for a payment in an amount at 120% of the "Estimated Administration Return".	Rejected
Existing shareholders	Provided pre-implementation funding and additional funding through a junior ranking secured facility. The existing shareholders retained their equity.	N/A – implemented outside of the plans
Licensor	Provided waivers and deferrals in respect of the group's licence arrangements.	N/A – implemented outside of the plans
Intercompany liabilities	Agreed to the capitalisation of intercompany liabilities.	N/A – implemented outside of the plans

Hurricane Energy: headline restructuring terms and voting on the plan		
Class	**Headline terms**	**Plan meeting results**
Unsecured bondholders	USD50m of the bonds released, other amendments to the bonds including pricing uplift and a maturity date extension. Allotment of 95% of the shares in the company.	Passed
Shareholders	Diluted equity to 5% of the shares in the company.	Rejected