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Is the New U.K. Restructuring Plan a Viable Alternative to Chapter 11?

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Editor's Note: *Transatlantic restructurings may have just gotten a little easier. Until now, transatlantic companies with New York law-governed debt looking to implement a balance-sheet restructuring enforceable against creditors in both the U.S. and Europe have primarily had two choices: a chapter 11 plan under the U.S. Bankruptcy Code, on the one hand, and on the other hand, a U.K. scheme of arrangement filed under Part 26 of the Companies Act 2006, coupled with recognition under chapter 15 of the U.S. Bankruptcy Code. At times, neither has been the perfect fit. Now, there is a new kid on the block.*

The U.K. government has enacted the Corporate Insolvency and Governance Act, which supplements the U.K.'s existing insolvency framework with new restructuring tools. One such tool is the new, but long-awaited, restructuring plan.[1] With certain characteristics that bring the position under the traditional scheme of arrangement more in line with that under chapter 11, the restructuring plan could be the versatile solution that transatlantic companies have been searching for under certain circumstances.

Is the Restructuring Plan Just a U.K. Chapter 11?

There certainly are many similarities. As is the case with a scheme of arrangement, both chapter 11 and the restructuring plan are (1) court-sanctioned processes that can be initiated by companies (including foreign companies with an appropriate connection to the U.S. or U.K., respectively); (2) recognized cross-border; (3) used to compromise secured creditors, unsecured creditors and shareholders; or (4) involve a high degree of public disclosure. However, they do not affect the directors' ordinary-course management powers.

The similarities do not stop there. Unlike a scheme of arrangement, both chapter 11 and the restructuring plan can be used to cram down dissenting classes of creditors and to implement a debt-for-equity swap without shareholder consent.

Both processes can be pre-planned and implemented relatively quickly by early negotiation and, where required, entering plan-support or lock-up agreements. As an indication, a chapter 11 could be implemented in approximately 45-90 days (although recent examples of a "speedy" prepack have required just 24 hours). A scheme of arrangement, which should be able to be used as a reasonable proxy for a restructuring plan, can be implemented in a similar time frame following commercial agreement.

In chapter 11, the company must place the claims of creditors into classes (based on their rights and interests, including the source of their debt and security in collateral). The company's chapter 11 plan requires the approval of at least one non-insider impaired class. The company will seek the bankruptcy court's approval of a disclosure statement and confirmation of its plan, and if approved, a confirmation order is issued by the court that binds all creditors.

For a U.K. restructuring plan, two court hearings will be held, and creditors (and/or shareholders) will be split into classes in a similar way. Creditors must be provided with sufficient information to make an informed decision (similar to an explanatory statement for a scheme of arrangement). Creditors or shareholders can challenge the class formation at the initial court hearing.

Once satisfied, the court will order that a vote of creditors and shareholders is taken, unless the appli-

1 Companies Act 2020, Pt 26A.

cant can convince the court that a class of creditors or shareholders has no genuine economic interest in the restructuring plan and therefore should be excluded. Subject to the voting threshold being passed, the court will consider whether to sanction the restructuring plan at a second court hearing. If sanctioned, the restructuring plan will bind all affected creditors.

How Are the Processes Different?

There remain several key differences between a chapter 11 and a restructuring plan. Different tools will be able to deliver different solutions. It is vital to assess at the outset what, in any given situation, is most important — and which tool is more likely to achieve this.

Voting Thresholds

A key factor when selecting the most appropriate implementation tool is the level of support required to approve the proposed restructuring. For a chapter 11, the company needs to secure, with respect to those creditors in the class that vote, (1) a majority in number, and (2) two-thirds in value of claims in a given class for that creditor class to accept a plan.

From a debtor's perspective, one disadvantage of a scheme of arrangement is that it requires a higher voting threshold. To obtain approval, the company must secure the votes of a majority in number and three-quarters in value of each class of creditors present and voting. These requirements have been relaxed under a restructuring plan, as the first test (majority in number) has been abolished.

So, a restructuring plan may be more attractive to a debtor than a chapter 11 where a dissenting minority of creditor claims of a necessary non-insider impaired class are held in a disproportionately large number of funds. However, a chapter 11 would be more attractive where the debtor cannot be certain of reaching the 75 percent in value threshold.

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Cross-Class Cram Down and Debt-for-Equity Swaps

Closely linked to voting thresholds is whether the consent of all classes is required. Historically, a major advantage of chapter 11 has been the ability to cram down dissenting classes of creditors (known as a "cross-class cram down" in the U.K.) and to bind dissenting creditors within a class, so long as the voting thresholds are met.

In chapter 11, cross-class cram down is possible provided that (1) at least one impaired (non-insider) class votes in favor, (2) the plan does not discriminate unfairly toward each impaired class that has voted against it, and (3) the plan is fair and equitable to the non-consenting class, which will be the case if (a) secured creditors receive either deferred cash payments (and interest thereon) equal to at least the value of their collateral or the indubitable equivalent of their claims and collateral (cannot be equity in the reorganized debtor), and (b) unsecured creditors (which might be paid in any combination of cash, notes and/or equity in a cramdown) are paid in full before any more junior class of claims or interests receives any recovery (known as the "absolute-priority rule").

Cross-class cram down is not available in a scheme of arrangement, one of the major drawbacks of the process to date. However, under a restructuring plan, cross-class cram down will be permitted for the first time in the U.K. if the following conditions are met: (1) the U.K. court is satisfied that none of the members of the dissenting class would be any worse off than in the event of the most likely relevant alternative scenario, as determined by the court (known as "Condition A"); and (2) the restructuring plan has been agreed to by a class that would receive payment or has a genuine economic interest in the company in the event of the relevant alternative (known as "Condition B").

Crucially, for cross-class cram down under a restructuring plan there is no absolute-priority rule. Consequently, the authors can envisage arguments that equity in the restructured enterprise can be given to the existing shareholders where, for example, the efforts of shareholder management are required for the successful future operation of the restructured business, despite the impairment of junior creditors. On its face, this is a breach of the absolute-priority rule. This might be justified where the equity is gifted from what would otherwise have been the senior creditors' share, but the difficulty will be justifying an equity allocation to former shareholders in circumstances in which the senior creditors are not prepared to gift that value from what would otherwise have been their entitlement, and it is instead to be taken from value that might otherwise be enjoyed by junior creditors. Although this is conceptually possible, just how far the court will be prepared to go when asked to sanction a restructuring plan that does not respect the absolute-priority rule remains to be seen.

Novel for the U.K., the authors could also see a form of "cram up" whereby junior creditors seek to impose a haircut on more senior creditors, although this could be challenging in practice. For example, this could result in increased focus on whether the juniors have the right to participate in the prescribed part (*i.e.*, the £600/800k pot of floating charge realisations in a U.K. insolvency available for distribution to unsecured creditors) or if any unsecured assets could generate realizations. The court will ultimately assess these points and decide, in its absolute discretion, whether to sanction the restructuring plan. So both chapter 11 and the restructuring plan can be used to implement a debt-for-equity swap without shareholder consent, and both can be used to cram down dissenting classes.

Stay-of-Enforcement Efforts

Transatlantic trading companies will be keen to obtain protection from creditor enforcement to enable their businesses to continue to trade while a restructuring is implemented. A chapter 11 petition gives rise to a statutory injunction (known as an "automatic stay"), which automatically comes into effect immediately upon the commencement of a chapter 11 case. The automatic stay prohibits all actions against the company by creditors, wherever they are located (due to the wide reach of the U.S. bankruptcy courts).

In addition, subject to certain limited exceptions, the filing of a bankruptcy petition will prevent counterparties from terminating contracts with the debtor (called "*ipso facto* clauses"). The stay and restrictions on *ipso facto* clauses have proven to be valuable tools to allow a business to continue trading while implementing a rescue.

In contrast, the Corporate Insolvency and Governance Act does not include a stay during the restructuring-plan process. In rare situations, however, the court has ordered a short stay on enforcement for a scheme of arrangement (which again should be a reasonable proxy for a restructuring plan). Other reforms implemented by this legislation introduce a freestanding moratorium that could be used alongside a restructuring plan, if the company is eligible; there are broad categories of companies that are not, such as companies that are party to capital markets arrangements. Similarly, other reforms introduced in the legislation provide for a restriction on *ipso facto* clauses for the supply of goods and services contracts, and this will be triggered where the court summons a meeting under a restructuring plan.

Thus, a chapter 11 is likely to continue to be attractive if an automatic (and worldwide) stay and protection of contracts is key. The U.K. regime can now achieve this, too, in certain circumstances.

DIP Financing

Funding is critical to many companies going through a rescue process. The U.S. Bankruptcy Code permits a company to obtain debtor-in-possession (DIP) financing while in bankruptcy in order to operate the business in chapter 11 and pay the costs of the process. The Code also grants the lenders of such DIP financing super-priority status, so long as the court is satisfied that the company cannot obtain such financing on less-burdensome terms, and non-consenting pre-petition secured lenders that are primed are "adequately protected."

On the other hand, in the U.K. there are no provisions for higher-ranking financing (any such priority is a matter of contractual agreement). The courts have also held that a scheme of arrangement (which can be used as a useful proxy for the restructuring plan) cannot impose new obligations on creditors to advance money. The restructuring plan itself can, post-implementation, provide for existing contractual priorities to be changed to permit new money with higher-ranking priority. Chapter 11 continues to be the go-to where DIP financing is the key to funding the restructuring, rather than funding the company after the restructuring.

Group Guarantees

Another element a large transatlantic group might look at when assessing restructuring venues is whether the restructuring process can release guarantees provided by group companies for the borrowing of another member of the same group. Ahead of a chapter 11, given that a group guarantor would not normally receive the direct benefit of the automatic stay or the other advantages of a chapter 11 filing of the borrower (*e.g.*, DIP financing), the group will need to carefully consider whether each guarantor will also need to file for chapter 11 in order to obtain the protection required by the group as a going concern (which might necessitate additional time and costs).

By contrast, the restructuring plan (akin to a scheme of arrangement) should be able to release group guarantees where they are closely connected to the primary obligation being compromised under the restructuring plan (given that without such a release the restructuring plan would be of limited use, as the lenders could still pursue the group guarantors). It is unlikely that such a guarantor release would be effective if the debt was U.S.-law governed and the guarantors were in the U.S.

Expense

Any company will also look at the costs involved in the process. Is there a forum where the restructuring can be achieved for a lower cost?

Chapter 11 has often been criticized as being a costly tool. The widespread adoption of pre-packaged and pre-arranged chapter 11 cases has largely eliminated any distinction between the costs of chapter 11 and the costs of a scheme of arrangement. The costs of a free-fall chapter 11 case, however, continue to be substantial. This is largely due to the ongoing and frequent court involvement and the establishment of creditors' committees paid by debtors.

The restructuring plan is analogous to a pre-arranged case in the U.S. and thus would be less costly than a free-fall case. Although there are two court hearings (the convening and the sanction hearing), once the restructuring plan is approved and sanctioned by the court, there is no ongoing court involvement in the implementation of the restructuring plan.

Court Discretion

The restructuring plan involves, as a final step, the sanction of the U.K. court. For a scheme of arrangement, the court has made it very clear that this is not a rubber-stamping exercise and that even if the necessary voting majorities are met, the court retains absolute discretion on whether to sanction the scheme of arrangement. The restructuring plan also provides for court discretion, both where there is cross-class cram down and where there is not.

By contrast, in chapter 11, when the confirmation requirements (which include that the plan is proposed in good faith and complies with the applicable provisions of the U.S. Bankruptcy Code) have been met, the court will proceed to approve the plan. How much the U.K. court will make of its discretion will remain to be seen, and only case law will tell.

Conclusion: Has a Restructuring Plan Come Together?

The new restructuring plan is clearly a move by the U.K. in the direction of the U.S. chapter 11 and an improvement

on the existing scheme of arrangement. The inclusion of cross-class cram down, along with the absence of the absolute-priority rule and numerosity test, may make the restructuring plan a flexible and attractive option for transatlantic companies in the right circumstances.

Nevertheless, it is hard not to think that this has been a missed opportunity. Without DIP financing, a broader moratorium and a stronger shield from *ipso facto* clauses, it is unlikely the restructuring plan will replace chapter 11 any time soon. What it does do, however, is provide transatlantic companies with more options, each to be considered on the merits of the individual case. **abi**

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