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VIRGIN ACTIVE RESTRUCTURING PLAN APPROVED BY THE ENGLISH COURT

In a much awaited decision, on 12 May 2021, the English High Court has approved a restructuring plan for the entities in the Virgin Active Group, an international health club operator. It is the first time that the restructuring plan process has been used to compromise landlord claims, in addition to other liabilities.

Key issues

- Dissenting creditors must be no worse off under a restructuring plan
- Restructuring plans cannot be used to compromise proprietary rights and the landlords retained their rights to determine the leases
- Each restructuring plan to be considered by the court on its own merits and based on the evidence provided
- Court has an important role in protecting creditors, including the interests of dissenting creditors (including landlords)
- If creditors are "out of the money" in the relevant alternative, then they can be excluded from voting on the plan by the court. If they are not excluded, the court will place no weight upon their disapproval of the plan

Introduction

The case (***Re Virgin Active Holdings Ltd, Virgin Active Ltd and Virgin Active Health Clubs Ltd [2021] EWHC 1246 (Ch)***) represents only the second time that an English court has exercised its discretion to impose a restructuring upon dissenting creditors across different classes (so called cross-class cramdown). It is important to note that in the absence of the restructuring plans for the Virgin Active Group, the likely relevant alternative (at the time the court was asked to approve the restructuring plan) was a formal insolvency as the Group was due to face a liquidity crisis this week. The court, in approving the restructuring plan, was satisfied that no member of the dissenting creditor classes would be worse off than they would be in the relevant alternative and that the plans had been agreed by a number representing 75% in value of at least one class of creditors, who would receive a payment or have a genuine economic interest in the relevant alternative.

Impact of the decision for landlords

It is worth remembering that the provisions of the legislation for a restructuring plan depend upon companies satisfying certain conditions. By virtue of these conditions, companies seeking to use a restructuring plan will be in financial difficulty and need to come to a compromise or arrangement with their creditors. The purpose of a restructuring plan is to eliminate, reduce or prevent or mitigate the effect of a company's financial difficulties. The nature of the compromise and its effect on creditors will necessarily be driven by the value of the business and level of its distress, which means that in situations where the value of the business breaks within the senior levels of the debt, creditors lower in the priority waterfall, are unlikely to be in a strong bargaining position. However, the court must be satisfied that where a restructuring plan is sought contrary to the wishes of any class of creditors, those creditors are no worse off than the relevant alternative in any given case.

Early commentators on the decision have expressed concerns that the decision sets a dangerous precedent and leaves landlords without a voice in

forcing them to accept the unfavourable terms of any restructuring. It should be noted that unlike the much used company voluntary arrangement (CVA), the restructuring plan is a court supervised process and therefore the court is obliged to consider each restructuring plan on its own merits and on the basis of the evidence provided. In addition, the landlord's proprietary rights cannot be affected by such, in the absence of any other agreements with the company, so a landlord can terminate the lease arrangements whether or not their asset is impaired by the process and/or they have voted for or against the proposals.

The overall treatment of creditors in a restructuring has not changed as the relative bargaining position of creditors is dependent upon their relative priority positions. The safeguards contained within the restructuring plan process are designed to protect creditors' interests. Creditors are able to challenge the proposal for a restructuring plan at an early stage before it is implemented. This may be considered an advantage when compared to challenges made in the context of a CVA, which are after the proposal has been agreed by the requisite creditor majority (without any court oversight). The challenges to a CVA are also at the instigation of the creditors and must be made within a limited timeframe, but as we have seen with the recent New Look case (***Lazari Properties 2 Limited and others v New Look Retailers Limited, Butters and another [2021] EWHC 1209 (Ch)***), it can take a number of months before the challenge is heard. The fact that the restructuring plan must be approved by the court, even in cases where it has received the requisite creditor approval, is also a feature which is designed to ensure that plans are scrutinised by the court in every case.

Terms of the Virgin Restructuring Plan

The Virgin Active restructuring plans divided creditors into seven separate classes, each group being offered a different deal under the terms of the restructuring. The terms of the restructuring plan were broadly as follows:

The Secured Creditors

- Extending the maturity of Senior facilities, deferring approx. £9.2m interest payments, permitting £50m of additional borrowing to rank *pari passu* on a secured basis, allowing the Virgin Active Group to retain the proceeds of planned sales of clubs, and a relaxation of financial covenants and events of default.

The Landlords - divided into five separate classes

- *Class A* - rent arrears paid within 3 business days, rent concession period of up to 3 years (fixed rent paid monthly), then revert to terms of original lease.
- *Class B* - rent arrears released and discharged, in return for lump sum, rent concession period again (concessionary rent), then revert to terms of original lease.
- *Class C* - rent arrears released and discharged, rent concession period rent haircut by 50%, but no rent paid until 1 January 2022, debt during period now to 1 January 2022 to be paid over 5 years (in monthly instalments), each C landlord can terminate on 30 days' notice (provided delivered within 90 days of restructuring effective date).
- *Class D* - rent arrears released and discharged, no future rents payable, no obligations, can get a "restructuring plan return" (lump sum payment),

rolling break right exercisable on 30 days' notice, if D landlord exercises break it gets 30 days' contractual rent.

- *Class E* - rent arrears released and discharged, lump sum, pass on income from sub-tenants to E landlords, rolling break right exercisable immediately on or after restructuring effective date.

General Property creditors

- All claims compromised in return for a payment of a restructuring plan return.

Voting on the plans

For a restructuring plan to be approved by the court, it relies upon at least one class of creditors to vote in favour of the plan by a 75% majority in value and for any dissenting creditors to be no worse off than in the likely relevant alternative. In the Virgin Active case, only two out the seven classes of creditors voted in favour of the restructuring plan, although these two classes represented overall between 72% and 77% in value of total debts of the relevant group companies. It meant that the court had to consider whether it should exercise its discretion to approve the scheme, against overall five dissenting classes of creditors (where some of the five classes registered 0% in favour of the restructuring plans), those comprised essentially landlords (Classes B-E) and the general property creditors. Objections raised by an Ad hoc group of landlords (AHG) focused on challenging the companies' evidence regarding the relevant alternative to the restructuring plan. On the facts and evidence filed they were unsuccessful.

The key issues

- Whether the dissenting creditors were “no worse off“ under the restructuring plan compared to the relevant alternative.
- Whether the restructuring plan had been approved by 75% of creditors in value of at least one class of creditors who had a genuine economic interest in the relevant alternative.
- Whether the court should exercise its discretion to approve the restructuring plan.

The key focus was on the first and third issues, it having been accepted on the evidence, that the Secured Creditors and landlords in Class A both satisfied the genuine economic interest test.

No worse off

As mentioned above, in order to approve the restructuring plans the court had to be satisfied that the dissenting creditors were “no worse off” than in the relevant alternative. Based on the evidence, the most likely relevant alternative was an administration, which envisaged a short period of trading to facilitate an accelerated sale of the business. The AHG would in the event of an administration be unsecured creditors, and as such they would be likely to receive only a small share in the prescribed part (a ring fenced fund reserved for unsecured creditors limited to £800k). Under the terms of the restructuring plan, they would receive up to 20% more than a return in administration. The restructuring plan return was also likely to be paid sooner than any payment of a dividend in an administration.

Court's discretion to approve the restructuring plan

It was noted by the judge that the Virgin Active companies could have asked the court to make an order to exclude the landlords altogether from the voting as they were clearly “out of the money“ and therefore (with echoes of IMO Car Wash (***Re Bluebrook Limited and other companies (IMO) [2009] EWHC 2114***)) the fact that they voted against the restructuring plan would not be a factor that ought to weigh heavily on the court in coming to its decision as to whether to sanction the restructuring plan. In this respect the judgment notes that those creditors who were “in the money” should be able to decide how the value of the business is allocated in the restructuring. This was in response to a criticism by the landlords that the shareholders had retained their interest in the future business despite being lower in priority than unsecured creditors in an insolvency waterfall. In this regard it is important to note that the legislation (unlike in some jurisdictions) does not contain an absolute priority rule which provides that junior creditors cannot be paid before all seniors are paid in full. In some respects the relative priority of creditors is protected by the comparison the court has to make in considering the relevant alternative, but once the court is satisfied that the dissenting creditors are “no worse off“, their objections to how any value in the business is allocated to others (including any shareholders) with the agreement of creditors who are “ in the money“ are given no weight by the court. This follows an earlier case ***DeepOcean [2020] EWHC 3549 (Ch),*** which held that a plan could be sanctioned in which different treatment and substantial value is given to some, but not all, creditors who are out of the money.

Valuation

In terms of the valuation of the business the decision confirms that there is no absolute obligation to conduct market testing as part of the restructuring process. Indeed in this case the judge remarked that the current climate was such that the market could hardly have been less favourable. Further general guidance is provided by the decision which recognises that the potential utility of the restructuring plan process ought not to be undermined by lengthy valuation disputes, however this must be balanced against the preservation of "the protection for the dissenting creditors given by the 'no worse off' test (and the courts general discretion)". Furthermore, in relation to whether the landlords could have achieved a better deal, it was noted that they chose not to adduce any evidence and the estimated rental values provided by the Virgin Group of companies went unchallenged as the best available evidence. In this case, despite criticism from the AHG landlords, there was a Relevant Alternative Report with which the court was satisfied.

Proprietary claims

It is also important to note that the landlords' proprietary rights were not affected by the restructuring plans. The landlords in this case retained their rights to determine the leases and the restructuring plans did not include any involuntary termination or surrender rights in respect of the leases. This follows the established principles in both ***Discovery(Northampton) v Debenhams Retail Ltd [2020] BCC 9*** and ***Re Instant Cash Loans Ltd [2019]EWHC 2795 (Ch) c***ases, albeit these related to CVAs and schemes respectively. In fact, in relation to certain landlords additional break clauses in the landlords' favour were included as part of the restructuring plans.

International recognition

A further factor considered by the court as a matter of exercising its discretion to sanction is whether the restructuring plan is likely to be recognised internationally. In the Virgin Active case, the relevant companies were incorporated in England with a majority of English law governed debts and as such, the court found that overseas recognition was likely. The court also favourably acknowledged the independent expert evidence confirming the likelihood of recognition from jurisdictions where non-UK guarantors of the Senior Facilities Agreement were based (in Singapore, Australia and Italy) and from those jurisdictions whose law governs a small number of lease guarantees (Spain and Portugal).

Key conclusions

- A court will consider each restructuring plan on its own merits and based on the evidence provided.
- For debtors the preferred option will usually be a consensual restructuring.
- The court process promotes a timely, transparent, and full disclosure in relation to the restructuring plan application. In this regard it is worth noting that the landlords were successful in their application for further disclosure for information (subject to various confidentiality requirements) at the convening stage of the process, to enable them to consider the proposals.
- The court has an important role in protecting creditors, including the interests of dissenting creditors (including landlords).
- While the case is the first time the restructuring plan has been used to compromise landlord claims, these were not the only claims compromised.
- The cost and time involved in preparing for and promoting a restructuring plan are significant. For these reasons restructuring plans are unlikely to be used in lower value cases. CVAs may still be more likely for SMEs.
- Creditor classes who do not vote in favour of the restructuring plan must be no worse off than in the relevant alternative.
- If the relevant alternative is a formal insolvency, unsecured creditors (including landlords) will be at the bottom of the priority waterfall and whether they have any economic interest will depend upon the value of business and where that value breaks.
- If creditors are “out of the money” in the relevant alternative, then the debtor can apply to court for them to be excluded from voting on the restructuring plan. If they are not excluded, and they are out of the money, the court is unlikely to place any weight on their rejection of the restructuring plan.
- Restructuring plans cannot be used to compromise proprietary rights.

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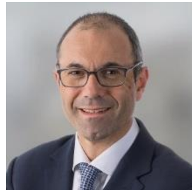

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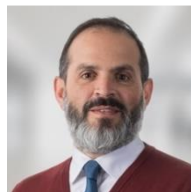

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