Falcon Chambers

Debt-restructuring plans; cramming down on landlords

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There has been a spate of recent decisions in which the court has been asked to sanction restructuring plans under s. 901 (G) of Companies Act 2006. This article examines two of those cases and assesses what they might mean for commercial landlords faced with a tenant in financial difficulty that seeks to invoke these provisions.

i) Introduction

Writing in the ***Woodfall Bulletin* 2022, 3 (Sep), 1-3**, Greville Healey explained the mechanisms created by Part 26 and 26A of the Companies Act 2006, whereby the court can sanction a scheme of arrangement for companies seeking a compromise with their creditors. In that article, Mr Healey examined the important decision in Oceanfill Ltd v Nuffield Health Wellbeing Limited [2022] EWHC 2178 (Ch), concerning the impact of such arrangements on the liability of a company's guarantors.

Since then, it appears that the prevailing economic uncertainty has led to an increase in the number of restructuring plans for which the court's sanction has been sought. The court has been obliged to consider applications for the sanction of on at least 7 occasions in the first six months of 2023 alone.[1] This article considers the two most recent reported decisions in this list and attempts to draw some conclusions about the way the court is approaching applications to sanction such schemes.

ii) The statutory restructuring provisions

[1] Re Nasmyth Group Ltd [2023] EWHC 696, Re Good Box Co Labs Ltd [2023] EWHC 274, Re Listrac Midco Ltd [2023] EWHC 460, Re The Great Annual Savings Company Ltd [2023] EWHC 1141, Re SGB-SMIT [2023] 6 WLUK 169, Re Fitness First Clubs Ltd [2023] EWHC 1699 and Re Prezzo Investco Ltd [2023[EWHC.

First, a brief reminder of the operation of the statutory schemes. Part 26 of the 2006 Act, which has been part of the 2006 Act since it first came into force, enabled a company to propose a compromise or arrangement to its creditors or members, In very simple terms a comprise with creditors involves a reduction and/or restructuring of debt owed to certain creditors or classes of creditor, in an effort to stave off insolvency. Under s. 899 of the 2006 Act, a compromise or arrangement may only be sanctioned by the court if a majority of the company's creditors, representing 75% in value of each class of creditors, voted in favour of it at a meeting convened for that purpose.

The major limitation on schemes under Part 26, is the ability of a single class of creditors to, in effect, veto implementation. Accordingly, as part of the package of emergency measures introduced at the outbreak of the Coronavirus pandemic, the Government introduced, via the Corporate Insolvency and Governance Act 2020, a new Part 26A.

The critical difference of these provisions to the existing Part 26 is the availability of the so-called 'cross class cram-down'. The restructuring plan can be imposed on a dissenting class or classes of creditors (for example, landlords) if at least one class approves the scheme with the requisite 75% majority. So, by s. 901G of the 2006 Act, the court has power to sanction an arrangement, even if one class dissents, provided that (by S. 901G (3)), the court is satisfied that, if the compromise or arrangement were to be sanctioned, none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative. The relevant alternative means whatever the court considers would be most likely to occur in relation to the company if the compromise were not sanctioned. This will usually be said to be administration or, even, insolvent liquidation.

For a more detailed treatment of these measures and their impact on the landlord and tenant relationship, see *Woodfall, Mainwork,* para. 7.096.1.

The new provisions therefore create a powerful weapon in the arsenal of insolvency practitioners acting for companies in financial difficulty, potentially to the considerable detriment of creditors, including landlords. The most recent quarterly statistics published by the Insolvency Service (for Q1 of 2023) suggest that the number of both restructuring plans

and CVAs have risen in 2023. This and the number of recent court applications for sanction under s. 901G suggests that the schemes are proving popular.

iii) *Re Fitness First Clubs Ltd*

In the first of the two most recent decisions under s. 901G, Mr Justice Michael Green sanctioned a restructuring plan in the face of opposition by five (out of nine) classes of creditors. The dissenting creditors were all landlords of premises used by the company, First First ("FF"), for operating gyms.

The company encountered significant financial difficulty, largely caused Covid-19, both directly as a result of the lockdowns, which forced it to shut gyms entirely, but also, it was said, due to a change in consumer habits as a result. Gym membership has not returned to pre-pandemic levels, particularly in Central London where the company's portfolio is concentrated.

The plan proposed by FF restructured liabilities almost entirely by reducing the rent payable under existing leases. A secured creditor and HMRC, the two other mains creditors of FF by value "*will be hardly impaired*". The landlords, under the plan, would be obliged to accept a reduced rent for a 3-year period and, in some cases, no rent at all. In fact, the leases were divided into a total of six classes, with differential treatment, determined by the profitability and importance to the business of the sites in question. Some liabilities were excluded altogether, on the basis that the related to premises, services or individuals deemed critical to the future operation of the business. The judge noted, interestingly, that this way of categorising leases has become commonplace in such plans and said that it was:

> "*well-settled that it is permissible to exclude and pay in full creditors from whom the ongoing supply of goods or services are viewed by the Company as critical to its future ability to trade or the success of the restructuring or with whom it might be impracticable or undesirable to require them to accept a compromise.*"

The creditor landlords complained about what they regarded as a lack of engagement and negotiation by FF before the plan was proposed. However, the judge did not consider that

these matters affected the substantive decision. There was no dispute that the plan had been agreed by 75% in value of one class of creditors (the secured creditor, Ms Best, and HMRC). Accordingly, Condition B in s. 901 (G) (5) was satisfied.

The main battleground was, therefore, the *"no worse off"* test, created by Condition A. The judge referred to the decision of Snowden J in Virgin Active and the 3-stage test proposed for addressing this test. First, what would be the most likely outcome if the plan is not sanctioned. Second, what would be the consequences of that outcome for the dissenting creditors. Thirdly, those consequences should then be compared to the outcome and consequences for the dissenting creditors under the proposed restricting plan.

The judge then noted that, identifying the relevant alternative for the first two stages of the analysis, *"the directors of the Company, being advised by their professional advisers, are normally in the best position to identify what will happen if a Scheme or Plan fails."* It might also, of course, be thought that the directors and their professional advisers have put together the plan in question and may well, therefore, have a vested interest in ensuring that it is sanctioned by the court. The potential outcome if the plan is not approved will always be to some degree speculative, since as Snowden J also noted, it

> "*involves the Court in considering a hypothetical counterfactual which may be subject to contingencies and which will, inevitably, be based upon assumptions which are themselves uncertain."*

Once the most likely alternative outcome has been identified, any creditors who, under that scenario, would receive no payment nor have any economic interest in the company will receive short shrift. They are said, in the jargon, to be 'out of the money' in the alternative insolvency scenario. Accordingly, little or no weight will be afforded to their views, since any alternative is likely to be better for them than this outcome (see Green J's discussion at [70] – [72]).

In this case, FF said that without the approval of the plan, it would go into administration. It had only survived for this long because of the financial assistance provided by Ms Best and her continued support was conditional on the implementation of the plan. She had filed a

witness statement stating that she would not make any further funding available. She was not, apparently, challenged on that assertion in cross-examination.

The dissenting landlords challenged the cashflow projections produced in evidence by FF as unreliable and also pointed to an existing facility which entitled FF to draw down a further £1.5m in lending from Ms Best. However, the judge was unimpressed by these arguments and concluded that FF would not be obliged to require Ms Best to make further funding available if she declined to do so. Administration leading to a pre-pack sale was therefore the most likely alternative outcome.

The judge then considered the evidence about the estimated outcome for each creditor in the event of administration compared to the restructuring plan. That evidence suggested that all landlords would receive a greater return if the plan was sanctioned (the precise comparison varying depending on the class of landlord; Class A landlords would receive 100p/£ in each scenario whereas, for example, class B1 landlords would, it was said, receive 38.14p/£ under the plan and only 5.49p/£ in administration).

It followed that Condition A was satisfied because, the judge held, for all dissenting classes, the returns under the plan were significantly higher than in the relevant alternative.

That was not, however, the end of the matter. Even where both of the pre-conditions in s. 901 (G) are satisfied, the court still retains a discretion to decide whether the proposed cramming down is, in all the circumstances, a fair outcome. Here, the landlords made two main arguments. First, that it was unfair to exclude from the plan altogether the parent company of FF, Maddox, in whom Ms Best had a c. 75% shareholding. Maddox was a major creditor of FF and, since it was excluded from the plan, that debt would not be compromised. In particular, Maddox would continue to be paid in full (at the date of c. £500,000 per month) for providing management services, whereas the landlords were obliged to accept reduced payments for the provision of gym space. However, the judge rejected this argument on the basis that (i) FF's board had deemed the services provided by Maddox to be critical to the continued trading of its business; and (ii) more generally, it was for Ms Best, as the economic owner of the business and a creditor ranking in priority to all except HMRC to decide how to

divide up the value in the company. Because the landlords would be 'out of the money' in an insolvency,

> "*The other creditors have no real entitlement to share in the restructuring surplus and cannot really sustain a complaint that it is all unfair.*"

Second, the landlords argued that the alternative outcome had been artificially generated by FF. It had spent around £1.4m in producing the plan and had it saved that money and drawn down an additional £1.5m from Ms Best, FF could have survived without any form of insolvency at all. This argument did not gain any traction at all with the judge. Ms Best had decided not to put any new money into FF unless the plan went through and that was not an unreasonable approach. In any case, if the conditions in s.901 (G) were satisfied, as the judge considered was the case here, then

> "*Parliament has decreed that where creditors are no worse off under the Plan than the relevant alternative, those creditors' opposition to the Plan can be overridden*."

Accordingly, the judge concluded that the restructuring plan should be sanctioned.

iv) *<u>Re Prezzo Investco Ltd</u>*

A week after the decision in <u>Re Fitness First</u>, Mr Justice Richard Smith, granted another application under s. 901 (G), approving a restructuring plan approved by Prezzo Investco Ltd ("Prezzo"), the casual dining chain of Italian restaurants. Here, the opposition to the plan was provided not by affected landlords but by HMRC.

Again, Prezzo's evidence was that it was in serious financial difficulty as a result of the pandemic, but compounded by a climate of inflationary price increases. In 2018, the original operator of the business (Prezzo Limited) had entered into a CVA which had resulted in a reduction of restaurants from 300 to 209 and the closure of 3 other restaurant brands. The present company had acquired the business and assets under a pre-pack administration sale in February 2021.

Prezzo was trading at a loss (some £4.5m in the 2022 financial year), with 47 loss making restaurants. Attempts had been made to market these sites or enter into consensual arrangements with landlords. When this did not succeed, Prezzo ceased trading form those sites. It owed c. £12m to HMRC in employment contributions (PAYE and NIC) and VAT and c. £32m to landlords on the loss-making sites

The proposed plan involved writing off all outstanding amounts owed to the landlords of the loss-making sites. HMRC would receive a cash payment equal to the value of certain assets subject to a floating charge, less the estimated cost of an administration process. The rationale for this proposal was that HMRC would rank as a preferential creditor in the event of Prezzo entering administration, but would only have recourse to such assets as were not subject to a prior fixed charge. HMRC would also receive an additional preferential creditor payment of £2m.

Perhaps surprisingly, it appears that none of the landlords affected by the plan decided to oppose the sanction. Presumably, they saw the writing on the wall and were satisfied that they were 'out of the money' in an administration/liquidation scenario and so saw no purpose in resisting the application. That, though, is merely speculation; the judgment does not record their position. In any case, Prezzo's evidence was that absent approval of the plan, the company would inevitably enter administration, in which case none of the landlords would receive anything at all.

HMRC did, however, object to the plan. Smith J followed the same tripartite analysis described above and concluded that the evidence clearly established that a pre-pack administration sale of the business was the relevant alternative. The judge also accepted that on this analysis, the creditors were no worse off under the restructuring plan. The conditions for approving the plan were therefore satisfied.

The judge then turned to the exercise of the discretion and, at [68] provided a handy summary of the various factors that have been identified by the decided authorities as relevant to that discretion:

(i) where creditors would receive no payment or have no economic interest in the company in the event of the relevant alternative, little or no weight is to be paid to their views;

(ii) the level of overall support for the plan is relevant, although not decisive;

(iii) whether the plan provides for a fair distribution of the benefits of the restructuring is relevant to the exercise of discretion;

(iv) when considering if a plan fairly allocates value between the different creditor classes, it is relevant to consider whether the priority as between them in the Relevant Alternative is reflected in the distributions under the plan, albeit a departure from that priority is not in itself fatal to sanction;

(v) the *source* of the benefits to be received under the restructuring, for example, whether from assets of the plan company or third parties willing to support the restructuring, will also be a relevant factor;

(vi) (vi) creditor non-opposition to sanction will be a relevant factor for the Court to take into account in the exercise of its discretion.

HMRC raised various arguments about why the approval of the plan would be unfair. These included (i) complaints about the size of the debt to be compromised (c. £12m); (ii) a failure by Prezzo to make any payments towards tax liabilities whilst the plan was prepared, despite continuing to collect VAT and deduct PAYE and NIC on behalf of employees; and (iii) that Prezzo had continued to make substantial payments to creditors which it deemed to be critical whilst paying nothing to HMRC.

HMRC's overall complaint was that Prezzo was trading to the detriment of HMRC, with the ongoing business funded by the collection of tax monies that should have been (but were not) paid over to HMRC. Whilst these specific complaints are of course bespoke to HMRC, they are resonant of complaints by landlords in this and other insolvency contexts, that a company is continuing to trade from premises without payment of rent and, therefore, to the benefit of other creditors at the expense of the landlord.

However, once again, HMRC's objections did not find favour. The judge considered that Prezzo had not acted unfairly and that HMRC would be paid almost all of the surplus which would be produced by the plan. Furthermore, whilst HMRC was in a special position as an involuntary creditor:

> "*those creditors the Company continued to pay (and proposes to exclude from the Plan) were (and remain) critical to the preservation of its business and ability to trade. In this regard, although HMRC went unpaid, so too did a number of other non-critical creditors, including significantly, the landlords of the loss-making sites, whose indebtedness extends to more than £32m. HMRC accepts that it may be necessary to pay "critical creditors" to preserve value and rescue a company's business as a going concern. I accept that the course undertaken by the Company and Prezzo Trading in this case was appropriate in the interests of creditors*."

In the circumstances, the proposed restructuring was, in the broadest sense, fair and was not, as had been alleged, being used as an instrument of abuse.

v) *Some conclusions*

These two cases do not mark any change of approach. Rather, the framework for analysing applications for sanction under s. 901 (G) put forward by Snowden J in the Virgin Active case is now firmly entrenched and these two decisions are useful illustrations of this. The same approach in principle is taken whether the objectors are (as in Fitness First) landlords who will be compelled to accept a reduced rent or (as in Prezzo) HMRC.

What these decisions demonstrate is just how difficult it is to make out a successful opposition to a scheme, at least where the formal requirements and procedure are correctly followed.

At first blush the objections cited by the landlords in Fitness First and by HMRC in Prezzo appear compelling; why should the company continue to trade at the expense of third party creditors? However, once one removes the landlord and tenant spectacles and views matter

through the prism of the 'rescue culture' more familiar to the insolvency practitioner, the decisions are easier to understand. Ultimately, if the evidence supports a conclusion that the objector will be no worse off by virtue of the restructuring, then they have little to complain about.

Any landlord that wishes to oppose a restructuring plan will therefore need to produce a very clear and compelling critique of the financial assessments; a mere plea of fairness (on the basis some other creditor will come out better off) appears to have slim prospects of success. The task is particularly difficult given the apparent deference owed to the directors and their advisers knowledge of the company's business and the likelihood of future financial outcomes.

On the other hand, the court's sanction is by no means guaranteed. For example, in another recent case, Re The Great Annual Saving Company Ltd [2023] EWHC 1141, Adam Johnson J upheld HMRC's objections and refused to sanction a restructuring scheme, essentially because the learned judge did not accept the financial analysis put forward to establish the outcomes under the alternative scenario. The judge was also critical of the fairness of the re-arrangement of priorities of payment under the restructuring plan.

Nevertheless, given the considerable recent success in obtaining the court's sanction for restructuring plans in the face of determined opposition from affected creditors, it seems likely that the Part 26A procedure may overtake alternative mechanisms, most obviously CVAs, particularly where the proposals are controversial and do not enjoy majority support. Certainly the number of such applications reaching the court suggests that they are currently seen as an attractive alternative by insolvency practitioners and, if the worst predictions of economic downturn are realised, they may become even more commonplace.