KIRKLAND & ELLIS

5 AUGUST 2020

The First UK Restructuring Plan: Virgin Atlantic's Solvent Recapitalisation

Learning points from the convening hearing

At a Glance

Kirkland is advising the UK Civil Aviation Authority on the restructuring of Virgin Atlantic Airways Limited (the "**Company**"), in the first restructuring plan under the new Part 26A of the Companies Act 2006. The convening hearing was held on 4 August, at which the Court granted permission to convene creditor meetings in accordance with the Company's proposals. Creditor meetings and the sanction hearing will be held at the end of August.

This represents a major first test of the new procedure, recently introduced under the Corporate Insolvency and Governance Act 2020 (effective from 26 June). The new plan offers the possibility of cross-class cram-down, to impose a restructuring on dissenting stakeholders, and the possibility of compromising operational as well as financial creditors.

The Company's solvent recapitalisation deal — which has the backing of key financial stakeholders — seeks to ensure the survival of the airline against the backdrop of the existential crisis in the travel industry, owing to Covid-19 and related restrictions. Crucially, the restructuring allows the Group's planes to continue in operation.

The convening hearing raised no major surprises, but illustrated a number of practical points which will inform practice and assist the growing numbers of companies and stakeholders considering pursuing a plan on potential restructurings. Those points are explored in this deck.

If successful, the deal will serve as an important template for restructurings under the new procedure.

1. This terminology is used in the explanatory notes to the Act.
2. As the Act inserts the restructuring plan provisions as new Part 26A of the Companies Act 2006, alongside schemes of arrangement in Part 26; the new Practice Statement governing court applications under Parts 26 and 26A refers to existing schemes of arrangement as "Part 26 schemes" and the new restructuring plan as "Part 26A schemes".

FURTHER BACKGROUND

For detailed analysis of the new Corporate Insolvency and Governance Act 2020 (the "**Act**"), including the new restructuring plan, see our *Alert*.

A NOTE ON TERMINOLOGY

The UK restructuring market has yet to settle definitively on what to call the new procedure – restructuring plan[1], "super-scheme" or "Part 26A scheme".[2]

In the Company's case, the court was content to use the term "restructuring plan"; we adopt that term in this deck.

'EX TEMPORE' JUDGMENT

The Court provided an 'ex tempore' oral judgment immediately following submissions on behalf of the Company. This deck reports that oral judgment; the final written judgment may differ slightly.

OUTLINE

Recap: New “Restructuring Plan”

The new, flexible procedure is modelled on schemes of arrangement, but with the key addition of cross-class cram-down — drawing inspiration from US Chapter 11 proceedings.

The new plan sits alongside schemes and company voluntary arrangements as a central tool in the UK’s restructuring toolkit. Like schemes (but unlike CVAs), restructuring plans can compromise dissenting **secured creditors**.

The Act inserts the new procedure into the existing Companies Act 2006 — alongside, and frequently **mirroring, provisions for schemes of arrangement**. The addition of **cross-class cram-down** to impose a restructuring on dissenting stakeholders addresses an often-cited limitation in the existing UK restructuring toolkit.

For a class of stakeholders to approve the plan, at least **75% in value**, of those voting, must vote in favour. Unlike in a scheme of arrangement, there is **no requirement for a majority in number** in this regard.

The plan offers the possibility of compromising **operational as well as financial creditors**, in a shift of approach for English restructuring law.

We expect the tool to play a role on **international restructurings**: non-English companies may use the new procedure, provided they have a sufficient connection to this jurisdiction.

There is **no formal provision for post-petition financing**. New funding must comply with permissions under existing debt documentation, unless new funding is granted under the plan itself.

There is no **automatic moratorium under the plan**. A new stand-alone moratorium is available under the Act (see our *Alert*), but eligibility, and the nature of the protection granted, are limited.

The Company's Plan

The restructuring plan forms part of a **broader suite of inter-conditional financial arrangements** with other stakeholders. The overall solvent recapitalisation deal involves a significant shareholder support package (including £200 million in cash, via a junior term loan facility) and new, third party secured debt financing (amounting to £170 million plus $30 million).

The plan itself includes **four classes** of plan creditor, as follows.[1]

CLASS	NATURE OF CLAIMS	TREATMENT UNDER THE PLAN	APPROVED PLAN?
RCF Lenders	► Under a fully drawn, $280 million secured revolving credit facility	► Certain security released (to make it available to new money provider); maturity date extended; margin increased; covenants amended; converted to term loan facility	► Yes – 100% agreed, in advance of convening hearing
Operating Lessor Creditors	► In relation to 24 aircraft on operating leases, with aggregate liability of c.$1.25 billion	► Offered three options: rent deferral; rent reduction and bullet repayment; or lease termination and redelivery of the leased aircraft	► Yes – 100% agreed, in advance of convening hearing
Connected Party Creditors	► With claims up to £400 million, including under certain licensing and JV agreements	► Amounts capitalised in exchange for preference shares in the Company's parent	► Yes – 100% agreed, in advance of convening hearing
Trade Creditors	► c.170 trade creditors with claims in aggregate of c.£55 million, with respect to goods or services supplied by the creditor ► The Company excluded certain trade creditors from the plan (among others, those owed less than £50,000, for logistical reasons)	► Amounts owed in respect of principal and accrued interest reduced by 20% ► 10% of the remaining balance to be paid shortly after the effective date of the recapitalisation ► 90% of the remaining balance to be paid in quarterly instalments, December 2020 – September 2022	► Not invited to sign plan support agreement – but extensive engagement and consultation ► **It remains to be seen whether the class of trade creditors will approve the plan**

Treatment of Trade Creditors / Notice: The Court was especially concerned to understand the treatment of the trade creditors (who had not been invited to sign plan support agreements), and in particular the adequacy of the 21 days' notice of the convening hearing (see Timeline). The Court was ultimately satisfied that the steps the Company had taken – which included a webinar to explain the recapitalisation and plan to the trade creditors, and offer them the opportunity to ask questions – were sufficient, especially in light of the compelling urgency of this case, and as the treatment of trade creditors under the plan was not particularly complex.

1. The Company originally intended to include finance lessors / finance lease lenders within the plan (across three separate classes in addition to those listed). However, once all finance lessors and finance lease lenders agreed to the proposed terms, the Company issued an addendum to its practice statement letter to the effect that these creditors would no longer be treated as plan creditors.

Issues Arising on the First Restructuring Plan

	GENERAL	THE COMPANY'S CASE
Financial Condition "Condition A": s901A(2)	The company must have encountered, or be likely to encounter, **financial difficulties** that are affecting (or will or may affect) its ability to carry on business as a going concern. The company **need not be insolvent** to propose a plan.	The Court had **little trouble in finding that the Company had encountered severe financial difficulties** affecting its ability to carry on business as a going concern, given the near-shutdown of the global passenger aviation industry in the ongoing Covid-19 pandemic. Evidence showed that, absent the proposed recapitalisation deal: ► the group's cashflow would drop to a critical level[1] in w/c 21 September; ► closing free cash would turn negative the following week; ► the Company's directors considered that administration proceedings would be inevitable by mid-September; and ► returns to the Company's unsecured creditors in administration would be substantially less than under the plan.
"Compromise or Arrangement" and Requisite Purpose "Condition B": s901A(3)	A "**compromise or arrangement**" must be proposed between the company and its creditors (or any class of them) or its members (or any class of them), and the **purpose** of the compromise or arrangement must be to "eliminate, reduce or prevent, or mitigate the effect of, any of the financial difficulties" described above.	The Court noted it was well-established that "compromise or arrangement" **requires some element of give and take**, but beyond that it is neither necessary nor desirable to attempt a definition of "compromise or arrangement". There was no reason to think that what was capable of amounting to a "compromise or arrangement" for a restructuring plan was any different to that for a scheme. The stated purpose of the Company's plan mirrored the legislative wording (left). The Court held that the **requisite purpose** of the compromise or arrangement (see left) was **phrased broadly and intended to be expansively construed**. The Court was **readily satisfied** that the purpose of the plan was to mitigate, and if possible eliminate, the Company's financial difficulties.

1. Namely, that the level of closing free cash would fall below a £75m threshold, below which the group's bondholders could potentially commence enforcement of security in respect of the group's landing slots at Heathrow.

Issues Arising on the First Restructuring Plan (cont.)

Jurisdiction

s901A(4)(b)

Recast Judgments Regulation

GENERAL

The Court has jurisdiction to make a convening order in respect of a "company", which for this purpose means any company liable to be wound up under the Insolvency Act 1986.[1]

In the case of a foreign company, the question is whether there is a "**sufficient connection**" with England. The court will also consider whether the scheme will have **international effectiveness**; the court is concerned not to act in vain. It is now clear that these latter questions fall to be determined at the sanction hearing (the second court hearing). At the convening hearing (the first court hearing), the court will only consider "any issues as to the ***existence*** of the court's jurisdiction to sanction the scheme" – and may indicate whether or not it sees a "**roadblock**" which would inevitably lead to the scheme not being sanctioned.[2]

THE COMPANY'S CASE

Jurisdiction in the Company's case was **fairly straightforward**, given that:

- it is incorporated in England and Wales (and has its centre of main interests in England) – and therefore there is no need to establish any further sufficient connection; and
- the vast majority of the documents to be restructuring under the plan are governed by English law.

The Court was **content to adopt the same practice in relation to the Recast Judgments Regulation** as that adopted in schemes of arrangement.[3] The Company had sought to rely on exceptions in Articles 8[4] and 25[5] of the Judgments Regulation to establish jurisdiction over the plan creditors. In the Company's case, several plan creditors are domiciled in the UK (in particular, 90 out of 168 trade creditors are domiciled here). The Court held this was **amply sufficient to engage the exception in Article 8** of the Judgments Regulation.

Notably, the Court held that the **exception in Article 25 of the Judgments Regulation was not engaged** in this case, given not *all* trade creditors had contracted with the Company on the basis of an English jurisdiction clause. However, this was immaterial in light of the Court's finding that it had jurisdiction based on the exception in Article 8.

The Company plans to file for recognition of the plan in the U.S. under **Chapter 15** of the Bankruptcy Code; the Company had provided expert evidence that such recognition was likely to be granted.

1. Section 901A(4)(b) of new Part 26A of the Companies Act 2006.
2. This is expressly stated in the new Practice Statement governing restructuring plans as well as schemes of arrangement, which builds on existing case law, and was clarified further in Flint's recent scheme of arrangement (*Re ColourOz Investment 2 LLC and others* [2020] EWHC 1864 (Ch)).
3. The Recast Judgments Regulation provides a general rule that any person domiciled in an EU Member State must be "sued" in the courts of that Member State; this rule is subject to certain exceptions. It has never been conclusively determined whether the relevant provisions apply to schemes of arrangement. In order to avoid determining this issue, the court has adopted the practice of assuming the relevant provisions do apply (proceeding on the basis that scheme creditors are "sued" by the company, and the scheme creditors are "defendants" to the scheme), and considering whether the court has jurisdiction over the scheme creditors on that basis.
4. In essence: if at least one creditor is domiciled in England, then Article 8 confers jurisdiction on the English court to sanction a scheme affecting the rights of creditors domiciled elsewhere in the EU, provided it is "expedient" to hear the claims together "to avoid the risk of irreconcilable judgments resulting from separate proceedings".
5. In essence, Article 25 confers jurisdiction on a court where a jurisdiction clause (whether exclusive or non-exclusive) provides for the courts in the relevant Member State to have jurisdiction to settle disputes.

Issues Arising on the First Restructuring Plan (cont.)

	GENERAL	THE COMPANY'S CASE
Class Constitution and Voting s901C	**Every creditor or shareholder whose rights are affected** by the plan must be permitted to vote.[1] Stakeholders vote on the company's proposed plan in **separate classes**. An application can be made to **exclude classes** of creditors / shareholders from voting where the court is satisfied that "none of the members of that class has a **genuine economic interest** in the company". **Voting threshold:** For a class of stakeholders to approve the plan, at least **75% in value**, of those voting, must vote in favour. s901G **Cross-class cram-down:** Crucially, the plan may still be confirmed by the court even where one or more classes do not vote in favour, provided: ► the court is satisfied that none of the members of the dissenting class(es) would be any worse off under the plan than they would be in the event of the "relevant alternative" (i.e. whatever the court considers would be most likely to occur if the plan were not confirmed); and ► at least one class who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative, has voted in favour. The court has discretion to decline to sanction a plan if it is not "**just and equitable**".[2]	**As anticipated, the court applied the same test for determining class constitution as for schemes of arrangement**: 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". This involves consideration of stakeholders' strict legal rights both absent, and under, the proposed plan. The Court refrained from lengthy reasoning on class constitution (given the lack of adversarial argument, and conscious that this was the first restructuring plan). It simply held that **none of the differences between restructuring plans and schemes of arrangement should be reflected in a different approach to class composition**. The approach to class constitution should be **broadly the same** – even having regard to the fact that the possibility of cross-class cram-down under a plan raises the possibility that, in some circumstances, a company may have an incentive to increase the number of classes. The Court **approved the Company's proposed class constitution** which divided the plan creditors into four classes (see here), with fairly little comment. 100% of the creditors in the first three classes have locked up to vote in support of the plan. As noted, it remains to be seen whether or not the trade creditor class will vote in favour of the plan, and therefore whether or not cross-class cram-down issues will fall to be determined at the sanction hearing. Notably, as the Company's **shareholders' rights are not affected** under the plan, there is no requirement for them to vote on it. (As noted, the broader recapitalisation deal, in parallel to the plan, involves a significant shareholder support package.)

1. **Aircraft-related interests:** the draft Corporate Insolvency and Governance Bill had provided that creditors with certain registered aircraft-related interests could not participate in the vote nor be compromised under the plan — or a scheme of arrangement — without their consent. This would have made it more difficult for the Company to pursue its plan. Fortunately, these provisions do not appear in the final Act.
2. This requirement does not appear in the legislation itself but in the explanatory notes to the Act.

Other Notable Issues

Deed Poll

As noted, finance lessors / finance lease lenders were originally to be included as plan creditors. As there was no direct payment covenant by the Company to the relevant creditors, the Company would have needed to execute a **deed of contribution** in favour of those creditors in order to create a direct claim to be compromised under the plan. In order to **avoid any potential uncertainty** as to the validity of that approach, the Company decided to **omit such creditors from the plan** once it had obtained their consent.

Cape Town Convention

Many of the Company's leased aircraft are subject to a **registered international interest** for the purposes of the Cape Town Convention[1]. The Convention provides that, following the occurrence of an "insolvency-related event"[2], a debtor is effectively required to give up possession of the leased aircraft to a creditor in respect of which an international interest has been registered (or cure all defaults); the **obligations owed by the debtor cannot be compromised in the insolvency proceedings**.

There has been **much debate as to whether this protection would apply** in the context of a scheme of arrangement – and now, that debate can extend to restructuring plans. The Company considers that its restructuring plan does not trigger an "insolvency-related event" for the purposes of the Cape Town Convention.

However, as each of the plan creditors with a relevant interest had indicated its support for the plan, there was **no need for the Court expressly to consider** this point.

"Ipso Facto" Clauses

The Act's reforms include a **prohibition on enforcement of so-called ipso facto clauses** — i.e., clauses allowing one party to a contract to terminate, or impose altered terms, solely on the basis of the insolvency of the counterparty — **in contracts for the supply of goods or services**.[3] This draws inspiration from US Chapter 11 proceedings and is designed to preserve a business's operational capabilities (and, by extension, value for stakeholders) through a restructuring. Critically, the UK provisions cover only supplier arrangements, not general commercial contracts.

The **rules restrict such action on the grounds of the new restructuring plan procedure** (as well as existing UK insolvency proceedings and the new stand-alone moratorium). Accordingly, the Company's suppliers cannot rely on termination provisions which might otherwise have been triggered by the making of the convening order in respect of its restructuring plan. However, certain safeguards and exclusions apply.

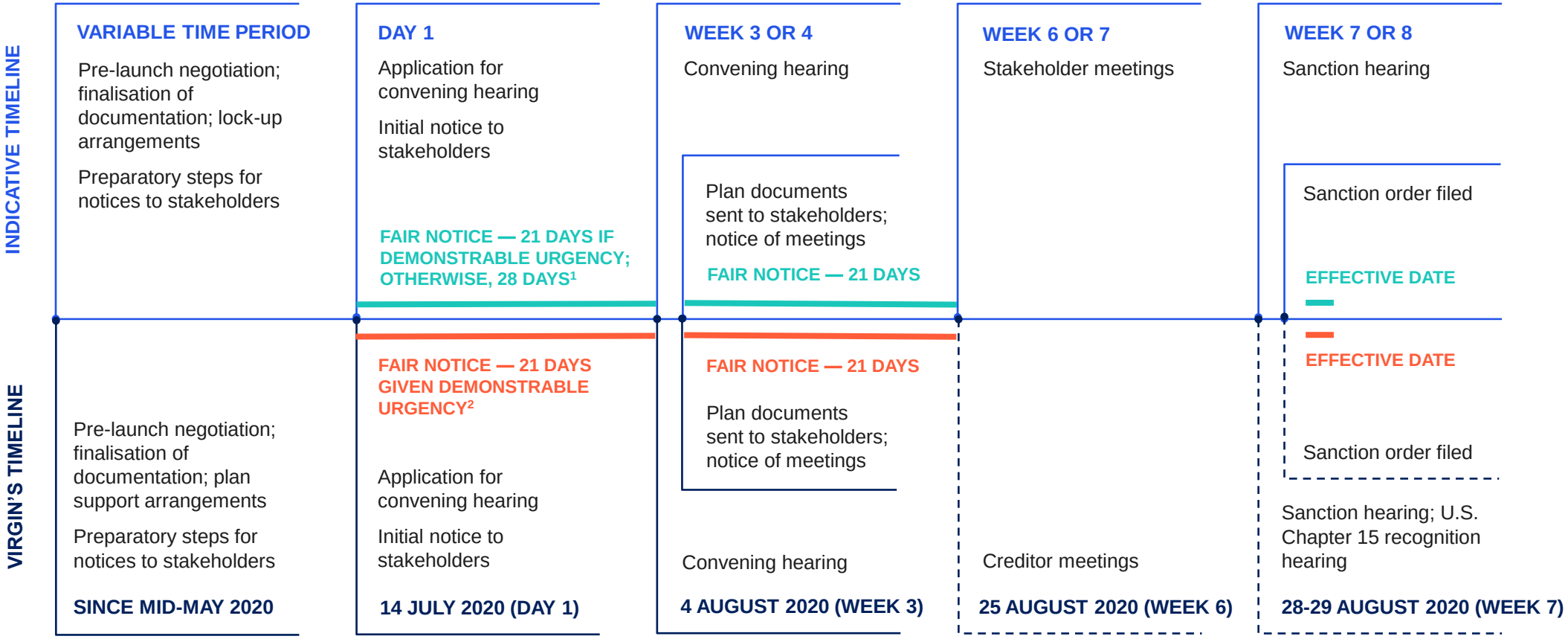
In particular, **Cape Town Convention interests are expressly excluded[4] from the restriction**, i.e., creditors with a registered international interest in relation to aircraft objects would not be restricted from termination, notwithstanding the new "ipso facto" regime – although, as noted, all such creditors have indicated their support for the plan.

1. The Convention on International Interests in Mobile Equipment and related protocols, transposed into English law by The International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015.
2. The definition of "insolvency-related event" means the commencement of "insolvency proceedings", which for this purpose is "liquidation, bankruptcy … or other collective judicial or administrative insolvency proceedings … in which the assets and affairs of the debtor are subject to control or supervision by a court …"; the operative provisions are framed by reference to the conduct of an insolvency office-holder. A scheme of arrangement or restructuring plan under the Companies Act 2006 (notably, not under the Insolvency Act) is a "debtor in possession" proceeding which does not involve the appointment of an insolvency office-holder.
3. New section 233B of the Insolvency Act 1986.
4. Paragraph 21 of new Schedule 4ZZA of the Insolvency Act 1986.

Timeline

Note: no express timeline is provided in the Act.

The indicative timeline below is suggested based on Kirkland's extensive experience of schemes of arrangement, and represents an expedited basis. Duration of the hearings, and the requisite period for the court to consider its judgment, will likely be **longer in the event of a contested plan**.

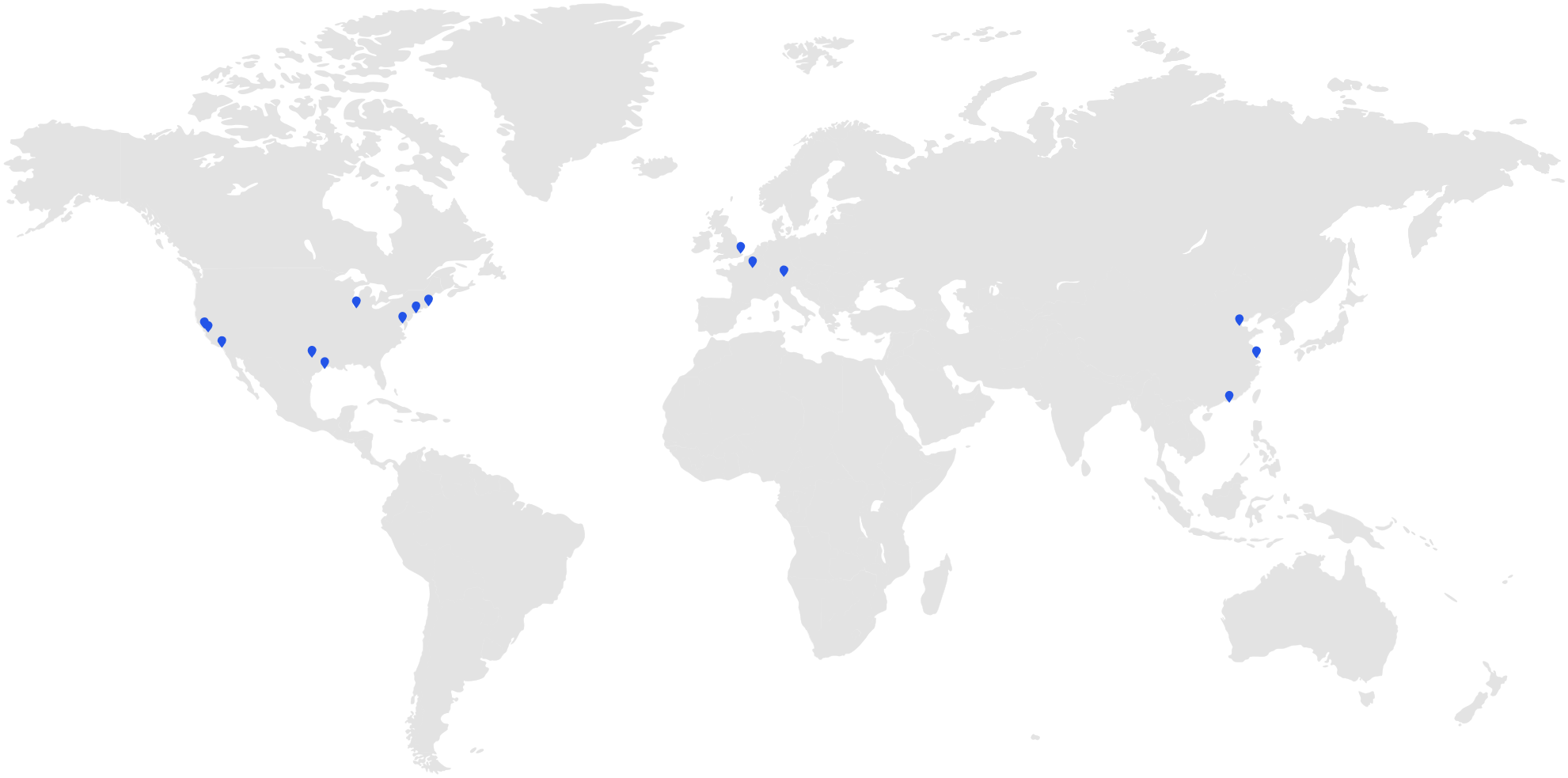


1. Under the new Practice Statement, notice "should be given to persons affected … in sufficient time to enable them to consider what is proposed, to take appropriate advice and, if so advised, to attend the convening hearing". In Flint's recent scheme of arrangement (*Re ColourOz Investment 2 LLC and others* [2020] EWHC 1864 (Ch)), the Court appeared to imply that the period between the initial notice to stakeholders (in the form of the practice statement letter) and the convening hearing should be four weeks if there is no significant urgency (or greater, if the scheme/plan involves stakeholders who are not sophisticated commercial investors or e.g. if little consultation has taken place with affected stakeholders before the scheme/plan is launched). This applies even where the overwhelming majority of scheme creditors / plan stakeholders have already approved the transaction via a lock-up agreement.
2. The Court was satisfied that the Company had given proper notice of its proposals – the creditor identification process appeared to be comprehensive and, unlike in Flint's case, there was compelling evidence that the matter was very urgent.

Key

Projected timeline for future events

International Reach



Beijing	Dallas	London	New York	San Francisco
Boston	Hong Kong	Los Angeles	Palo Alto	Shanghai
Chicago	Houston	Munich	Paris	Washington, D.C.