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English Court Sanctions Virgin Active's Restructuring Plans, Following Major Challenge from Landlords

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At a Glance

The English court yesterday handed down a judgment sanctioning Virgin Active's restructuring plans, notwithstanding a major challenge by certain landlords.[1] This landmark judgment is the first fully-opposed restructuring plan, following an extensive five-day sanction hearing, and the first to compromise multiple classes of landlords.

The judgment closely follows the court comprehensively rejecting landlords' challenge to New Look's company voluntary arrangement (see our *Alert*).

Kirkland & Ellis is hosting two webinars with market experts discussing the legal and market implications of these cases on Tuesday, May 18 and Tuesday, June 1. For more information and to register, see here.

Core takeaways from Snowden J.'s Virgin Active judgment include:

- on valuation:
  - the court will be concerned not to permit lengthy valuation disputes, to avoid undermining the utility of the restructuring plan procedure (whilst preserving creditor protections)
  - the court conducted a thorough analysis of the plan companies' valuation evidence, opposed by the ad hoc group of landlords — one of only a handful of cases in which the English courts have had to analyse distressed valuations in this way
  - there is no absolute obligation to conduct a market testing process
  - absent competing valuation evidence from the opposing landlords, the court could not do anything other than assess the restructuring plans on the basis of the evidence before it

- on matters of discretion:
  - since the dissenting lower-ranking classes would be out of the money in the relevant alternative to the restructuring plans, the court attached little weight to either the numerical opposition to the plans in those classes (absent any evidence explaining why they had voted against the plans) or to opposing landlords' objections as to what the secured creditors had agreed with the plan companies as to the share of the post-restructuring equity
  - instead, it is essentially for those creditors who are "in the money" to determine how to divide up any value or potential future benefits that use of the business and assets might generate post-restructuring.

Key terms of the restructuring plans

Virgin Active's restructuring comprised three parallel restructuring plans.

Stakeholder	Key Terms	Approval (by value, of those voting)
Secured Creditors	• No haircut; three-year extension to maturity	100% in each of the three plans

	• Various amendments to the senior facilities agreement	
Landlords	• Divided into five classes, certain of which were substantively unimpaired, certain of which switched to turnover rents, and certain of which switched to zero rents under the plans, in return for payment of 120% of the estimated outcome in the administration alternative • Critically, the plans included "break rights" for all landlords to take back and re-let their properties	Voting varied between plan companies: Class A: 99–100% Class B: 19–45% Class C: 0–66% Class D: 0% Class E: 0–8%
Other unsecured creditors	• Claims of certain unsecured "general property creditors" compromised in return for payment of 120% of the estimated outcome in the administration alternative	0–7%
Shareholders	• Not included within, or compromised by, the restructuring plans • Package of support from shareholders/affiliates, including capitalisation of intercompany liabilities, waiver of licence fees, provision of £45 million new money by way of loans (pre-	N/A

	and post-implementation) and up to £6 million of equity

Questions for determination

The plan companies sought the court's sanction for the restructuring plans. Given not all classes had approved the plans, three questions arose for the court's consideration:

1. If the restructuring plans were sanctioned, would any member of a dissenting class be any worse off than they would be in the event of the relevant alternative? This is often described as the "no worse off" test.
2. Had each restructuring plan been approved by at least 75% of those voting in any class that would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative?
3. In all the circumstances, should the court exercise its discretion to sanction the restructuring plans?

There was no dispute as to whether the second question was satisfied, given the secured creditors' class had approved the plans.

"No worse off" test

The court noted that determining whether this test is satisfied is an inherently uncertain exercise, given the court must consider a hypothetical comparator, based on assumptions and possibly subject to contingencies.

The court held:

- the most likely relevant alternative to Virgin Active's restructuring plans was a trading administration, involving the accelerated sale of the most valuable parts of the plan companies' businesses;
- "it is obviously important that the potential utility of [the new restructuring plan procedure] is not undermined by lengthy valuation disputes, but that the protection for dissenting creditors given by the "no worse off" test (and the court's general discretion) must be preserved";[2]
- there is no absolute obligation to conduct a market testing process as part of a restructuring; rather, the question is whether it was necessary or practicable in the circumstances of the case (including by reference to whether such an exercise would be likely to have resulted in a materially more reliable valuation than that actually undertaken);
- the fruits of any market testing exercise in this case would have to be treated with extreme caution, given it would have involved offering gym and leisure businesses for sale during a time of prolonged closure owing to Covid-19 restrictions — i.e., "the market into which such testing would have been done could hardly have been less favourable";[3]
- the valuations and calculations in the plan companies' evidence appeared to be reasonable and capable of being relied upon for the purposes of determining whether to sanction the plans;
- if any landlord genuinely believed they could obtain a demonstrably better deal than in the relevant alternative, they had had ample opportunity to adduce evidence to that effect (and had not done so); and
- based on the evidence, each dissenting class of plan creditor would be no worse off under the plans than in the relevant alternative.

Accordingly, the "no worse off" test was satisfied.

Exercise of discretion

The legislation gives little guidance on the factors that are relevant when the court is exercising its discretion to sanction a restructuring plan that not all classes have approved.

The court made the following comments regarding the exercise of its discretion in such a scenario (following the first "cross-class cram-down" in the DeepOcean case, in which Kirkland advised the group — see our *Alert*):

- conceptually, a restructuring plan may give different treatment and substantial value to some, but not all, creditors who are out of the money (citing *DeepOcean*);
- since the opposing landlords would be out of the money in the relevant alternative, the court attached little weight to the numerical opposition to the plans in the lower-ranking classes (absent any evidence explaining why they had voted against the plans);
- for the same reason, opposing landlords' objections to what the secured creditors had agreed with the plan companies as to the share of the "restructuring surplus" (i.e., the value preserved or created by the restructuring) carried no weight;
- instead, it is for those creditors who are "in the money" to determine how to divide up any value or potential future benefits that use of the business and assets might generate post-restructuring;
- if there had been no secured creditors and the battle on sanction had been between assenting Class A landlords vs. dissenting landlord classes (where each class would have been "in the money" in the relevant alternative), the court might well have to look closely at whether the proposed compromise with the assenting class was a real "compromise or arrangement", or a manipulation of the classes, and whether the dissenting class(es) received a share of the "restructuring surplus" that was proportionate or comparable to the compromise they were being asked to make; in addition, the court would want to fully understand the benefits to be conferred on shareholders had this been at the expense of creditors who were "in the money";
- the differential treatment between landlord classes was explained by reference to the profitability and commercial importance that the plan companies attached to the relevant clubs;
- there was nothing inappropriate in choosing to use a restructuring plan rather than a company voluntary arrangement (where the evidence indicated a company voluntary arrangement was likely to be blocked by the landlords' votes);

- the retention of equity by the shareholders was predicated on substantial "new value" offered by the shareholders (which the court distinguished from the waiver of existing liabilities); and
- the court accepted evidence that the new money lent by the shareholders could not have been obtained on the same or better terms from any other source in the market.

Costs

The question of parties' costs has been reserved for a further hearing.

Comment

Snowden J.'s reasoned, 72-page sanction judgment provides significant guidance as to the court's approach to sanctioning a restructuring plan that not every class has approved.

By reference to the long-established stakeholder hierarchy in insolvency, and Parliament's intentions in introducing the new restructuring plan procedure, it is clear that the votes of out-of-the-money classes (and their views as to the appropriate distribution of post-restructuring rights) are likely to be given little to no weight by the court — unless they produce credible evidence that they are *not* in fact out of the money in the relevant alternative.

We look forward to discussing the implications of this and the New Look judgment in more detail on our forthcoming webinars, and are always available to discuss further with interested clients.

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1. *Re Virgin Active Holdings Ltd, Virgin Active Ltd and Virgin Active Health Clubs Ltd* [2021] EWHC 814 (Ch) (convening) and [2021] EWHC 1246 (Ch) (sanction)↩
2. Sanction judgment at [130]↩
3. *Ibid.* at [145]↩

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