KIRKLAND & ELLIS

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The First UK Cross-Class Cram-Down

At a Glance

Kirkland advised the DeepOcean group on its restructuring plans under the new Part 26A of the UK Companies Act 2006, including the ground-breaking first application of "cross-class cram-down" — i.e., using the acceptance of consenting class(es) to bind class(es) which has/have not accepted the plan.

The UK cable laying and trenching business of the DeepOcean group had long been underperforming. Three companies within this sub-group (the **Companies**) proposed parallel restructuring plans in order to achieve a solvent wind-down and avoid the negative impact of insolvent liquidation on the rest of the group. Two of the three plans were approved by the requisite majority of creditors in each class. In the third plan, whilst one of the two classes voted unanimously in favour, the requisite majority was (narrowly) not reached in the other class.

This therefore became the test case for the critical element of the new restructuring plan procedure: cross-class cram-down.

The court sanctioned all three restructuring plans on 13 January 2021 and handed down its reasoned judgment on 28 January 2021. The judgment includes extremely helpful guidance on the application of cross-class cram-down which we expect to be followed in future cases, including:

- a plan company will have "a fair wind behind it" in seeking sanction provided the relevant statutory conditions are met;
- the court will carefully consider questions of "horizontal comparability", i.e., whether the plan provides for differences in treatment of creditors among themselves and, if so, whether those differences are justified; and
- the court will carefully consider the level of support for the plan and turnout, particularly in the dissenting class(es).

This deck explores key issues including:

Early plans: This is only the third time that a restructuring plan has been sanctioned, following the introduction of the procedure in June 2020. Kirkland has advised on all three UK restructuring plans to date. See *here* for information on Virgin Atlantic's restructuring plan and *here* for PizzaExpress.

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 is, together with schemes and company voluntary arrangements, a central tool in the UK’s restructuring toolkit. Like schemes (but unlike CVAs), restructuring plans can compromise dissenting **secured creditors**.

The Corporate Insolvency and Governance Act 2020 inserted 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**.

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.

Background

In October 2020, the DeepOcean group concluded that it could not further fund the loss-making cable laying and trenching sub-group operated by the Companies and their subsidiaries (the "CL&T Group") and accordingly the CL&T Group's operations were unsustainable and would need to be wound down.

The group engaged Alvarez & Marsal to prepare an entity priority model ("EPM") to establish potential recoveries for stakeholders. The EPM set out two scenarios: insolvency of the CL&T Group (plus lender-led enforcement over the Norwegian group) or more extensive insolvency proceedings across all group companies.

SCENARIO	EFFECT	LIKELY RESULT	ESTIMATED RECOVERIES
CL&T Group Insolvency	► The wider group determines that it can no longer fund the CL&T Group and the Companies enter administration or liquidation	► Would trigger a breach of the facilities agreement ► Secured creditors likely to accelerate their claims, exercise their rights under a Norwegian law share pledge over the shares of the Companies' parent and enforce parent guarantee ► *Likelihood:* Most likely scenario — presented to the court as the most likely **"relevant alternative"** to the restructuring plans. See further here	► Plan creditors (other than secured creditors) would receive nominal or nil returns ► Returns marginally lower than in Group Liquidation scenario below
Group Liquidation	► All group companies (including the Companies) enter into insolvency proceedings in their respective local jurisdictions	► All operations would cease ► Assets would be sold at the assumed liquidation values ► *Likelihood:* Less likely than CL&T Group Insolvency scenario, above	► Plan creditors (other than secured creditors) would receive nominal or nil returns ► Returns marginally higher than in CL&T Group Insolvency scenario above

Use of restructuring plans

The group then considered whether restructuring plans could be used to provide a better outcome for stakeholders:

- Restructuring plans to be proposed by members of the CL&T Group, to achieve a solvent wind-down; wider group to introduce funding into the CL&T Group in order to fund the wind-down
- Thereby:
  - Allowing a solvent wind-down of the CL&T Group (and the release of parent guarantees)
  - Avoiding formal insolvencies / enforcement, which would be disruptive to the wider group's trading / business
  - Achieving a higher return for plan creditors than in either of the above alternatives (see next page)
  - Providing increased certainty of return and a faster distribution than in formal insolvency proceedings

DeepOcean's restructuring plans

Each of the Companies — DeepOcean 1 UK Limited ("DO1"), DeepOcean Subsea Cables Limited ("DSC") and Enshore Subsea Limited ("ES") — was incorporated in England, with its centre of main interests in England. The Companies proposed parallel, inter-conditional restructuring plans, as described below. In parallel, the sponsor agreed to make a $15m equity investment available to the group, dependent on satisfactory arrangements being put in place to wind down the Companies and sanction of the restructuring plans.

CLASS	NATURE OF CREDITOR / CLAIMS	TREATMENT UNDER THE PLAN	DO1	DSC	ES
Secured lenders	▶ Lenders under c.€141m secured multi-currency facilities agreement; English law / jurisdiction ▶ Security granted over all or substantially all of the Companies' assets ▶ (DO1 was original borrower / guarantor; DSC and ES acceded as additional borrowers/guarantors in Nov. 2019)	▶ Secured lenders to release their claims against the Companies (including guarantees and security, and including in security in respect of the shares of the Companies) ▶ Secured lenders retain their claims against other obligors in the Group. Facilities agreement amended and restated: maturities extended to Feb. 2025; margin reduced; financial covenants reset; all subsisting defaults waived	100% approved	100% approved	100% approved
UK landlord	▶ Single landlord, in respect of claim under a UK lease entered into by DO1	▶ Original proposal: claim to be released in full in return for payment of c.4% of its claim (cf. nil return in relevant alternative) ▶ Right to recover its property ▶ Negotiated settlement agreement to assign lease to another group company — disclosed	Approved (100%)	N/A	N/A
Vessel owners	▶ Owners of two vessels chartered by DO1, in respect of claims under UK vessel charter contracts	▶ Original proposal: claims to be released in full in return for payment of c.5.2% of their claims (cf. c.1.2% return in relevant alternative), plus potential mitigation from re-chartering vessels ▶ Right to recover their vessels ▶ Negotiated settlement agreements for cash consideration linked to outstanding hire and to retain certain specialist equipment on the vessels that belonged to the group — disclosed	100% approved	N/A	N/A
All other creditors (other than excluded creditors)	▶ Including claims owed to suppliers, sub-contractors and trade creditors ▶ Excluded claims of employees, tax claims, intercompany claims and claims required to be funded to ensure completion of a substantial project estimated to generate c.£4m gross (forming part of the consideration available for distribution under the plans)	▶ Claims to be released in full in return for payment of: – c.4% of their claims, for creditors of DO1 or DSC (cf. nil return in relevant alternative) – c.8.2% of their claims, for creditors of ES (cf. c.4.2% return in relevant alternative)	100% in value, of those voting, approved	c.65% by value, of those voting, approved — **therefore requisite 75% majority not met**	91% in value, of those voting, approved

The first cross-class cram-down

This was the first time the court had been asked to sanction a plan which had not been approved by all stakeholder classes.

GENERAL

Statutory conditions

A restructuring plan may still be confirmed by the court even where one or more classes do not vote in favour, provided:

- **Condition A:** 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
- **Condition B:** 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.[1]

Discretionary factors

Even if these conditions have been met, the court still has discretion as to whether to sanction a plan.

This is clear from the use of the word "may" in the legislation and is emphasised in the legislative explanatory notes, which provide that a court "will still have an absolute discretion whether or not to sanction a restructuring plan, and may refuse sanction on the grounds that it would not be just and equitable to do so, even if the conditions [above] have been met".[2] The words of the statute give little guidance on the factors that are relevant when the court is exercising its discretion to sanction a restructuring plan.

DEEPOCEAN'S CASE

Statutory conditions

It was clear that the statutory conditions were met based on the Companies' detailed valuation evidence (in the form of the EPM):

- **Condition A:** the plan terms were structured specifically to provide a return of 4% above that in the "relevant alternative", which the court confirmed to be the CL&T Group Insolvency scenario. The court likened this test to the "vertical" comparison undertaken for the purposes of an unfair prejudice challenge to a company voluntary arrangement; and
- **Condition B:** DSC's plan had been approved by the secured creditor class who would make a recovery out of the charged assets to be realised in an insolvency of DSC, which would be one of the consequences of the CL&T Group Insolvency scenario. Accordingly, the court held that it followed that each would have a genuine economic interest in DSC in the event of the relevant alternative.

Discretionary factors

The court took, as its starting point, the traditional approach that the court adopts when sanctioning a scheme of arrangement (or a restructuring plan approved by all classes) — albeit with necessary differences given the possibility of binding a dissenting class. The court:

- held the legislative explanatory notes indicate that a plan company will have "a fair wind behind it" in seeking sanction where Conditions A and B are met; and
- considered questions of "horizontal comparability", i.e., whether the plan provides for differences in treatment of creditors among themselves and, if so, whether those differences are justified. The court likened this test to the "horizontal" comparison undertaken for the purposes of an unfair prejudice challenge to a company voluntary arrangement.

Of course, each case will be fact-specific. Various facts of DeepOcean's case militated strongly in favour of sanction, including, e.g., the back-drop of the solvent wind-down; the high degree of certainty of payment post-completion; the overwhelming support across 7 of the 8 stakeholder classes (across the 3 plans); the fact that, even in the dissenting class, 65% had voted in favour; and the absence of any formal challenge. See further learning points on the next page.

1. Section 901G of the Companies Act 2006
2. Paragraph 192 of the explanatory notes to the Act; see also paragraph 190

Cram-down: lessons for future cases

Based on the DeepOcean sanction judgment, we expect the court to approach future restructuring plan cases involving a dissenting class as follows:

1. **Identification of "relevant alternative"** — this will be a preliminary question in each case, although little guidance arises from DeepOcean's case given the clear, undisputed evidence as to the counter-factual and the financial consequences of that counter-factual because the Companies were not in any scenario being preserved as going concerns

2. **Consideration of Condition A** — i.e. 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":

   - Starting point will normally be a comparison against the relevant counterfactual scenario of the value of the likely restructuring dividend, or the amount of any discount to the par value of each creditor's debt

   - However, the broad wording of "any worse off" appears to require the court to take into account the impact of the plan on all aspects of the company's liability to the creditor concerned, including matters such as timing and the security (i.e. certainty of receipt) of any covenant to pay

3. **Consideration of Condition B** — i.e. 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:

   - This is a question of evidence; it is clear from DeepOcean's case that even a small recovery (here, by the secured lenders) in the relevant alternative should suffice for this purpose

   - The court may revisit class constitution at the sanction hearing if there appears to have been some "artificiality" in the creation of classes in order to ensure Condition B is satisfied (provided the possibility of artificiality only becomes apparent at the sanction stage)

4. **Discretionary matters** — a plan company will have "a fair wind behind it" in seeking sanction if Conditions A and B are met. In exercising its discretion the court will consider:

   - the overall support for the plan and whether the plan stakeholders were fairly represented at the plan meetings — in particular, voting/turnout in any dissenting class(es) and (if possible) why dissenting stakeholders in the dissenting class(es) did not approve the plan; low turnout at a dissenting class meeting may affect the question of how much weight is to be given to that vote

   - questions of "horizontal comparability", i.e. whether the plan provides for differences in treatment of creditors among themselves and, if so, whether those differences are justified. In particular, the court will be concerned to ascertain whether there has been a fair distribution of the benefits of the restructuring (termed the "restructuring surplus") between those classes who have agreed the restructuring plan and those who have not

   - other "traditional" matters of discretion in respect of a scheme of arrangement, e.g., whether any stakeholder was influenced by any collateral interest or voted otherwise than honestly and in good faith, with a view to the interests of their class; whether any stakeholders excluded from the plan were excluded for good commercial reasons; whether there is any "blot" on the plan (i.e. anything which causes concern as to how it will operate in practice); and whether the plan is likely to be substantially effective in other relevant jurisdictions

Other interesting issues

Solvent wind-down / requisite purpose test

As noted, this is the first time a restructuring plan has been used to facilitate a solvent wind-down, rather than to facilitate a rescue.

The restructuring plan legislation requires that the purpose of the compromise or arrangement must be to "eliminate, reduce or prevent, or mitigate the effect of" financial difficulties that are affecting (or will or may affect) the company's ability to carry on business *as a going concern.*[1]

The question was raised whether the Companies' plans met the requisite purpose, in light of the fact that there was no intention that the Companies would carry on business as a going concern if the plans became effective.

The court held the requisite purpose test should be approached as follows:

- first, identify the effect of the financial difficulties; then
- second, determine whether the compromise or arrangement has, as its purpose, a lessening or reduction in the gravity or seriousness of that effect.

The court was prepared to construe the "purpose" test expansively. Here, even if there was no mitigating effect on the Companies' ability to continue to carry on business as a going concern, the plans had a mitigating effect on the severity of the losses which the creditors could otherwise sustain.

Accordingly the court determined this was sufficient to satisfy the requisite purpose test.

1. Section 901A(3)(b) and 901A(2) of the Companies Act 2006

Bar date

In order to enable the plans to take effect, we designed the plans so that they required plan creditors (other than secured creditors) to lodge their claims by a bar date falling three months after the plans become effective, with the purpose of drawing a "line in the sand" around future claims.

If a plan creditor does not submit notice of its claim by the bar date, it will not be entitled to receive any plan consideration, but it will nevertheless be bound by the terms of the plans and its plan claims will be released. The plans also provide a mechanism for the adjudication of disputed claims.

A bar date was similarly set in the scheme of arrangement of Noble Group, in which Kirkland represented the group. DeepOcean is the first use of a bar date in the context of a restructuring plan.

Other interesting issues (cont.)

Turnout

Turnout in the “other (unsecured) plan creditors” class in each plan was relatively low — between 29% and 35% in number.

A low turnout is not in itself a reason to refuse to sanction a scheme or restructuring plan.[1] Where turnout is low the court will consider whether the low turnout was due to creditors simply choosing not to engage or because they were unable to engage, the latter being something that could threaten the conclusion that the vote was representative of the class.[2]

The court noted that the relatively low turnout was “not particularly surprising” given the composition of the “other plan creditors” classes (i.e., suppliers, sub-contractors and trade creditors, with relatively small claims). It held there was nothing to suggest any plan creditor had been unable to engage (as opposed to simply choosing not to do so), and no reason to think that the votes at any such meetings were not representative of their class.

Accordingly, the court concluded that the relatively low turnout in certain classes was not a reason to refuse to sanction the plans.

Fully locked-up consenting class

In *Virgin Atlantic*[3], the court expressly declined to decide whether the power to bind a non-consenting class can be activated by including within a restructuring plan a class of creditors who would otherwise all have been prepared to enter into consensual arrangements to effect the restructuring of their rights. It was unnecessary to decide this point in Virgin’s case, because each class approved the plan.

However, this point arose directly in DeepOcean’s case because the consenting secured creditor class in DSC’s plan had fully locked-up to vote in favour of the plan in advance of the first (convening) hearing.

The court held that, while there may be some cross-class cram-down cases in which there is “artificiality” in the creation of classes (to ensure Condition B is satisfied), there was no sign of that in DeepOcean’s case. Rather, it was clear that the two DSC classes were properly constituted.

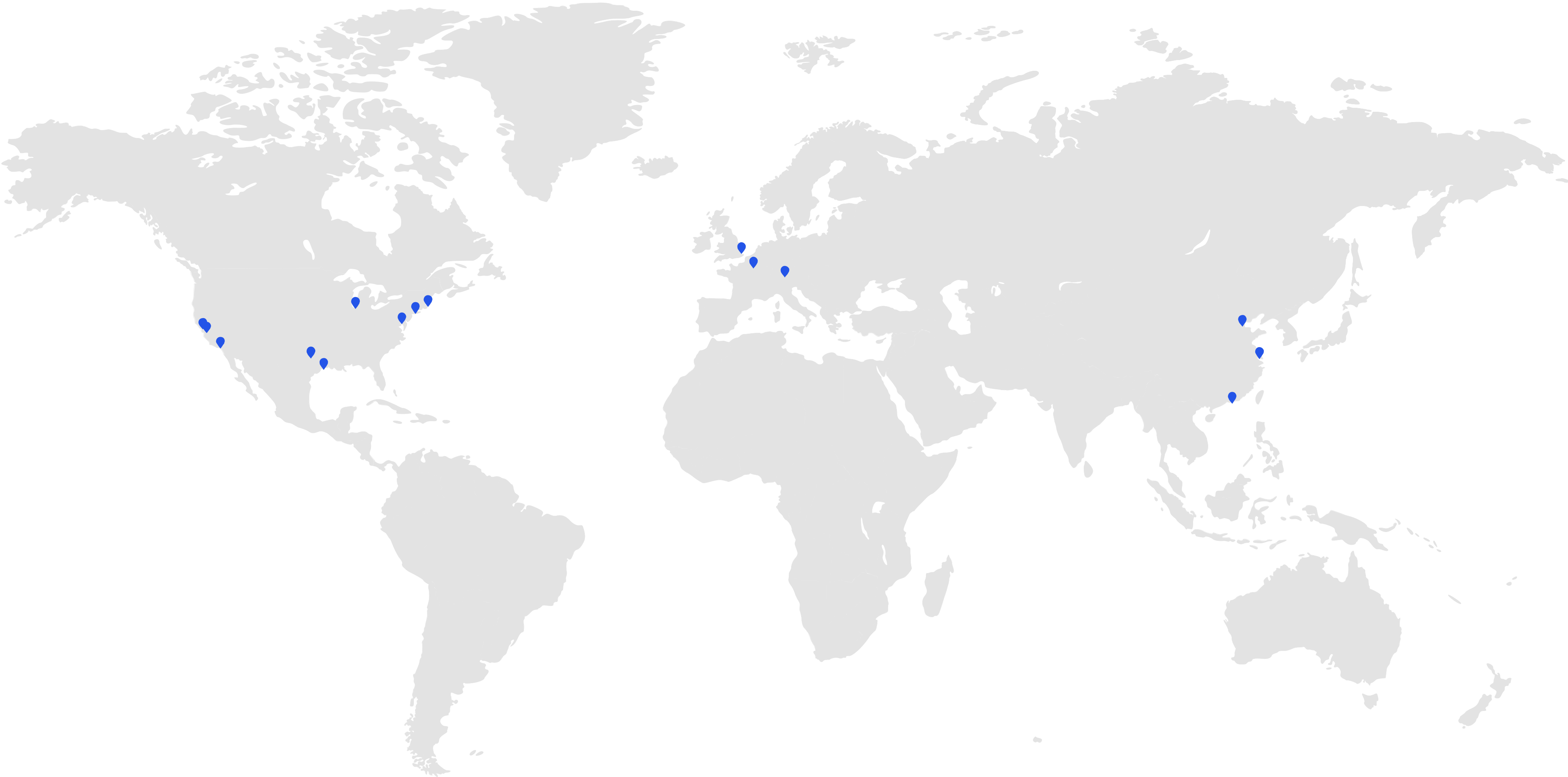
However, the court held that where the possibility of artificiality only becomes apparent at sanction stage, the court may be prepared to revisit the conclusion it reached on class constitution at the convening hearing.

Can a plan bind “out of the money” stakeholders excluded from voting?

Although this point did not arise in DeepOcean’s case, the sanction judgment contains a helpful *obiter* view that a restructuring plan *is* capable of binding a class of stakeholders that have been excluded from voting on a plan on the grounds that the court is satisfied they do not have a genuine economic interest in the company[4]. This reflects Kirkland’s interpretation of the statutory provisions.

1. *Re British Aviation Insurance Company Ltd* [2006]; *Re Cape plc* [2006]
2. *Re Osiris Insurance Limited* [1991]; *Re Instant Cash Loans* [2019]
3. *Re Virgin Atlantic Airways Ltd* [2020]
4. Pursuant to s.901C(4) of the Companies Act 2006

International Reach



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