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Insights

FAIR'S FAIR: THE CONCEPT OF FAIRNESS IN PART 26A RESTRUCTURING PLANS

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SUMMARY

Is there now an established test of fairness for the sanction of a Part 26A Restructuring Plan? In *Re Virgin Active [2021] EWHC 1246 (Ch) at [219]-[221]*, the Court was quick to dismiss the idea despite remarks to the contrary included within the Explanatory Notes to the Corporate Insolvency and Governance Act 2020 ("**CIGA 2020**"). However, subsequent Part 26A cases have demonstrated that the Court will weigh in on the fairness of a Plan prior to sanction and is prepared to test Plan proponents in the interests of those being compromised.

The general approach and level of scrutiny applied to the question of fairness by the Court tends to differ from case to case, often depending upon the level of challenge posed by Plan creditors, and is not confined to a consideration of such matters only within the context of cross-class cram down under section 901G Companies Act 2006 ("**CA 2006**").

Particularly in light of recent case law, it is becoming increasingly difficult to argue that there is still no established test of fairness for Plans. Some of the principles which have guided the Court's analysis of fairness, and the exercise of its broader discretion over sanction, were recently (and conveniently) listed in *Re Prezzo Investco Ltd [2023] EWHC 1679 (Ch) at [68]*. Will this list simply continue to grow over time, as developed by practice, or will it eventually be distilled into a definitive test through Parliamentary intervention?

Since its inception under CIGA 2020, there has been no shortage of legal commentary on the effectiveness of the legislation governing Part 26A Restructuring Plans, and the ways in which the judiciary have interpreted and resolved various gaps in the legislation through individual Part 26A cases.

One of the most widely debated topics currently is the nature and scope of the Court's power to refuse sanction of a Plan on the basis of an 'absolute' discretion allocated by the legislation, even in circumstances where the other statutory prerequisites are satisfied.

Such a discretion is available to the Court by virtue of the permissive, but not prescriptive, language of section 901F(1) CA 2006, and section 901G(2) in the context of cross-class cram down, which states:

> "*Section 901F (Court sanction for compromise or arrangement)*
>
> *(1) If a number representing 75% in value of the creditors or class of creditors or members or class of members (as the case may be), present and voting either in person or by proxy at the meeting summoned under section 901C, agree a compromise or arrangement,* ***the court may****, on an application under this section, sanction the compromise or arrangement.*
>
> *…*
>
> *Section 901G (Sanction for compromise or arrangement where one or more classes dissent)*
>
> *…*
>
> *(2) If conditions A and B are met, the fact that the dissenting class has not agreed the compromise or arrangement* ***does not prevent the court*** *from sanctioning it under section 901F."*
>
> (emphasis added)

Through this carefully framed wording, we can infer that Parliament's intention was for the Court's role in sanctioning Plans to go beyond simply ensuring that the procedural statutory prerequisites and voting thresholds have been satisfied. But what is the purpose of granting the Court a discretion in this respect if it is not accompanied by any guidance on how to use it, and how active should the Court be in scrutinising the merits of a Plan as a result? These are important and unresolved questions, and until further legislative guidance is given, the Court is arguably left to deliberate on the parameters of its own power. This invariably leads to greater uncertainty for practitioners in mapping out all possible outcomes and evidencing to the Court when and how its 'absolute' discretion should be used.

A large majority of Part 26A cases have pointed to the concept of fairness as a primary element the Court will consider as part of its overarching discretion on sanction. This idea generally arose as a result of the Explanatory Notes to CIGA 2020 which, at paragraphs 15 and 190, state:

> "*15. … As is the case with Part 26 schemes, the court will always have absolute discretion over whether to sanction a restructuring plan. For example, even if the conditions of cross-class cram down are met, the court may refuse to sanction a restructuring plan on the basis it is not just and equitable.*
>
> …

> *190. … Drawing on well-established principles in schemes of arrangement, the court has absolute discretion over whether to refuse to sanction a plan even though the necessary procedural requirements have been met. This may be, for example, because a plan is not just and equitable.*"

These references to '*just and equitable*' may simply have been a hangover from the initial drafting of CIGA 2020. The 2018 Government Response to the Insolvency Service's 2016 consultation on insolvency and corporate governance (at page 72) refers to the intention for the Court to retain an absolute discretion to confirm a Plan based on just and equitable grounds. Whilst it may be the case that some form of '*just and equitable*' test was initially proposed, but later scrapped, the retention of the '*just and equitable*' language in the CIGA 2020 Explanatory Notes has caused considerable confusion in Part 26A cases to date. The Court has been quick to dismiss the idea that the definitive test for the exercise of the Court's discretion is one of fairness (*see Re Virgin Active Holdings Ltd [2021] EWHC 1246 (Ch) at [219]-[221]*) not least because, without a consistent frame of reference laid out by Parliament, subjective concepts such as '*just and equitable*' are notoriously tricky for the Court to deal with, particularly in circumstances where, by its very nature, few receive under a Plan what they would ideally like.

But despite those comments, and the various references thereto in subsequent cases, we have seen that in most, if not all, Part 26A cases, fairness is acknowledged, debated and ruled upon *as if it was* a statutory prerequisite.

Against this backdrop, therefore, this article takes a deeper dive into some of the more recent Part 26A cases to examine whether there is now an established test of fairness for the sanction of a Plan at common law and, if so, how that test has come to be defined by the Court and how consistently and stringently it is applied as a hurdle to sanction.

IS THERE AN ESTABLISHED TEST FOR FAIRNESS FOR PART 26A RESTRUCTURING PLANS?

As mentioned above, the Court has demonstrably shown in many cases since *Re Virgin Active* that it does not overlook the question of fairness when determining whether or not to sanction a Plan. Not only has it been used as a guiding principle in most, if not all, of the sanction hearings which have come to the Court thusfar, but as we have seen from recent cases such as *Re Nasmyth Group Ltd [2023] EWHC 988 (Ch)* and *Re The Great Annual Savings Co Ltd [2023] EWHC 1141 (Ch)*, the Court has even been prepared to refuse sanction of a Plan on the basis of an opposing creditor's argument that the Plan operates 'unfairly' against it. The Court has even gone so far as to expressly cite the "*test of fairness*" as part of the sanction process (see *Re Amicus Finance Plc (in administration) [2021] EWHC 3036 (Ch) at [40-45]; Re Hong Kong Airlines Ltd [2022] EWHC 3210 (Ch) at [48-50]; and Re SGB-SMIT GmbH [2023] EWHC 2551 (Ch) at [15] and [26]*).

This "*test of fairness*" tends to manifest in one of two ways: (i) a prerequisite to sanction that the Court examines in all cases (the "**proactive approach**"; see, for example, *Re Virgin Atlantic Airways Ltd [2020] EWHC 2376 (Ch), Re Gategroup Guarantee Ltd [2021] EWHC 775 (Ch)* and *Re Hong Kong Airlines Ltd*); or (ii) a ground for challenge which provides a basis for additional Court scrutiny and activates the Court's discretion to refuse sanction (the "**reactive approach**"; see, for example, *Re Houst Ltd [2022] EWHC 1941 (Ch), Re Nasmyth Group Ltd* and *Re The Great Annual Savings Co Ltd*).

Perhaps unsurprisingly, the degree of challenge from Plan creditors appears to inform the level of scrutiny attached to the Court's examination of fairness. In *Re Smile Telecoms Holdings Ltd [2022] EWHC 740 (Ch)*, for example, one of the compromised senior lenders to the debtor (Afreximbank) had been excluded from voting on the Plan, based on the debtor's analysis that it was out-of-the-money in the relevant alternative. Afreximbank objected to the Plan on the grounds of fairness and provided to the debtor an alternative valuation report claiming that it was, in fact, in-the-money. Importantly, however, it failed to attend the hearing to make representations to that effect to the Court. The Court sanctioned the Plan despite having notice of those objections. Referring to Afreximbank's conduct, the Court stated (at [53-55]) that "*if a creditor or member wishes to oppose a scheme or plan based on a contention that the company's valuation evidence as to the outcome for creditors or members in the relevant alternative is wrong, they must stop shouting from the spectators' seats and step up to the plate… In the absence of such steps being taken… I do not consider that I am required to (or could) attempt an analysis of the valuation points made in Afreximbank's letter of 4 March 2022…*". This, it is argued, demonstrates a strict reactive approach to judging fairness. Although evidence was brought to the Court's attention challenging the basis of the exclusion of certain creditors from voting, the Court declined to investigate further in the absence of the challenging creditor filing expert evidence of its own and making formal representations at Court.

A similar approach was taken by Mr Justice Zacaroli in *Re Houst Ltd* which followed soon after *Re Smile Telecoms Holdings Ltd*. In that case, HMRC (as a compromised Plan creditor) noted their objections in principle to the debtor's Plan but failed to '*step up to the plate*' and make representations to that effect at Court. The Plan was sanctioned, despite effecting a departure from the ordinary distribution waterfall in the relevant alternative, and one of the reasons cited by the Court (at [42]) was that HMRC had full notice of the Plan and, although they had voted against it, failed to attend the hearing to present any arguments against sanction.

In contrast, it appears that in other cases such as *Re Nasmyth Group Ltd* and *Re The Great Annual Savings Co Ltd,* the Court has taken less of a strict reactive approach. Particularly in *Re The Great Annual Savings Co Ltd*, it was noted (at [62]) that it would be too restrictive to require Plan challengers to adduce their own expert evidence in all cases, and the focus should instead be on whether the Plan proponent's own evidential burden of proof is satisfied in the face of scrutiny. In light of representations made by HMRC at the sanction hearing, the Court concluded (at [135-138])

that the Plan did operate unfairly and the Court's concerns were not assuaged by the debtor's submissions that HMRC were on notice of the debtor's ailing financial position but had "*declined to engage*". This could be seen as the Court more proactively taking it upon itself to measure the balance of interests of compromised creditors by stress-testing the terms of a Plan without those creditors necessarily having to incur the time and costs of producing extensive evidence to challenge which, without sufficient access to management and financial information of the debtor, may be practically difficult for Plan creditors to produce in any event.

An even stricter proactive approach would involve the Court examining fairness in the absence of any creditor opposition. This was done in *Re Hong Kong Airlines Ltd*, for example, which (at [48-50]) described the test for fairness as "*well settled*" and "*part of the sanction process*". Despite the lack of objection from creditors, the Court still touched upon the fairness of the Plan and, in coming to the conclusion that the Plan was fair, focused solely on the materially better returns for creditors generally in contrast to the relevant alternative. A similar approach was taken by the Court in *Re Chaptre Finance Plc [2023] EWHC 2276 (Ch)* and *Re Yunneng Wind Power Co. Ltd [2023] EWHC 2275 (Ch)*. It seems apparent from these cases that fairness, whilst still considered and ruled upon by the Court, is perhaps scrutinised less in the absence of creditor opposition, coming back to the notion confirmed early on in Part 26A's lifetime that "*properly informed creditors who have sufficient time to consider the proposal and voting at a fairly conducted meeting are very likely to be the best judges of their own commercial interests*" (see *Re Pizza Express Financing 2 Plc [2020] EWHC 3933 (Ch) at [17],* which referred back to Lindley LJ's guidance in *Re English, Scottish and Australian Charter Bank (1893) 3 Ch 385*).

Naturally, the Court will be reluctant to take too critical an approach in circumstances where no creditors have raised a formal objection, and perhaps a lack of opposition in itself provides a basis on which the Court may conclude that the Plan is fair. Nonetheless, it is clear from an examination of the cases above that some form of fairness test is adopted in each case whether or not the legislation provides for the same. In the absence of any legislative guidance on what such a test looks like, the Court has drawn analogies from a variety of different concepts.

ADOPTING A TEST OF FAIRNESS FROM SCHEMES OF ARRANGEMENT AND COMPANY VOLUNTARY ARRANGEMENTS

When Part 26A CA 2006 came into force, many commentators praised its similarity to Part 26 Schemes of Arrangement, and the certainty that this would bring to debtors proposing Plans where Scheme case law is applicable by analogy. This was indeed the approach taken in the first ever Plan to come to Court for sanction, namely *Re Virgin Atlantic Airways Ltd*, in which Mr Justice Snowden (at [68]) referred back to the often cited formulation laid out in *Re Telewest Communications plc (No. 2) [2005] BCC 36 at [20-22]*:

> *"As explained by David Richards J in Telewest, the requirement that a scheme be a "fair" scheme does not mean that the court imposes its own view of what is in the interests of*

creditors or even what is the "best" scheme. Fairness in this context means that the scheme must be one that "an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve." … if the Court is satisfied that the class was fairly represented and properly consulted, it will be "slow to differ" from the result at the meeting."

There are two factors to this often-cited fairness test. The first is one of rationality: the Court should act to safeguard a rationally prepared Plan from irrational bargaining by Plan creditors. The second factor qualifies the first: the Court will be "*slow to differ*" from the views of a given class in determining whether the Plan operates fairly against them, so long as that class was fairly represented and properly consulted. The second factor in particular presents a problem in Part 26A cases where (unlike for Part 26 Schemes) the Court can be asked to deviate from the views of a fairly represented and properly consulted but dissenting class of creditor via an application for cross-class cram down (see Mr Justice Trower's comments in *Re DeepOcean 1 UK Ltd [2021] EWHC 138 (Ch) at [45]*).

In cases where no cross-class cram down is required, perhaps this test alone is sufficient. There is certainly evidence for this notion in such cases as *Re Hong Kong Airlines Ltd* where this was the only test applied to judge the fairness of the Plan (and the test was quickly satisfied). But in cases where cross-class cram down is sought, the Court has looked into other areas of law for guidance in determining the question of whether the Plan operates fairly.

Re The Great Annual Savings Co Ltd is a good example of this. In that case, the majority of classes who voted in favour of the Plan comprised out-of-the-money creditors who were offered a positive return as part of the Plan. HMRC, having voted against the Plan, would have seen its preferential claim compromised to enable a distribution to those out-of-the-money creditors who would rank behind it in the relevant alternative. The need for cross-class cram down was engaged, and having dismissed the utility of the test in *Re Telewest Communications plc (No. 2)* for the reasons noted above, the Court (at [103]) instead asked a different question:

"a more pertinent question to ask in such a case is whether the plan provides a fair distribution of the benefits generated by the restructuring between those classes who have agreed to it and those who have not, notwithstanding that their interests are different. If it does provide a fair distribution, that is likely to indicate that the negative vote of the dissenting class was not rationally motivated, which would support sanctioning the plan despite the dissent. And the converse is also true: if there is not a fair distribution, that is likely to indicate that the dissenting class has voted rationally, and that would support the Court refusing sanction."

This is largely analogous to the horizontal comparator used to determine cases of unfair prejudice in company voluntary arrangements and has been used as a discretionary factor in cases of cross-class cram down as early as *Re DeepOcean 1 UK Ltd* (see Mr Justice Trower's comments at [62]). It

posits that, whilst there is no prohibition on differential treatment for creditors *inter se* under a Plan, any differential treatment must be justified. In the case of *Re The Great Annual Savings Co Ltd*, the Court concluded (at [132]) that the mechanism used to generate the benefits under the Plan (commonly referred to as the 'restructuring surplus') was effectively the eradication of debt owed to HMRC and prioritising of payments to various unsecured creditors at HMRC's expense. Unlike the existing secured creditor and equity, HMRC stood to gain very little (if anything) if the Plan was successful in restoring the debtor's financial viability, despite providing (through its compromise) the bulk of what was required to achieve a successful restructuring.

Contrast this with the position in *Re Houst Ltd* where, although HMRC stood to receive a smaller proportion of distributions under the Plan than under the statutory distribution waterfall in administration, the Plan still produced a better outcome for HMRC than in that relevant alternative and the new value generated from the Plan came principally from a capital injection by shareholders (as opposed to the eradication of HMRC debt). The differential treatment in this case was justifiable on the basis that the restructuring surplus was divided more proportionately, and was generated primarily from volunteering stakeholders, rather than forcibly taken from crammed down creditors.

Another central reference point to the question of whether differential treatment is justified is the relevant alternative. This is closer to the "vertical comparator" used in CVA unfair prejudice claims and is particularly interesting to analyse in circumstances where there is nothing to prohibit a Plan from departing from the statutory waterfall of priorities in an insolvent administration or liquidation (i.e. the absolute priority rule commonly known from US Chapter 11 was ultimately not carried over into Part 26A CA 2006, see *Re Houst Ltd* at [30]). This is what the debtor in *Re The Great Annual Savings Co Ltd* tried to achieve albeit unsuccessfully, and it is clear from cases like *Re Houst Ltd* that the Court will give greater scrutiny to the fairness of a Plan where a departure from the ordinary waterfall of priorities is proposed.

Whilst there may be inconsistency between cases as to the exact test applied, what is clear is that the Court is motivated to ensure that any sanctioned Plan is not only capable of successful implementation, but that it reflects a rational deal vis-à-vis all relevant stakeholders whilst simultaneously recognising that not everyone can, or will, receive ideally what they would like. Given the lack of legislative guidance on how to assess fairness, however, the Court is left to grapple with a growing mixture of quasi-rules and principles developed on a case-by-case basis in order to fill in the gaps. Many of these were conveniently summarised by Mr Justice Richard Smith in *Re Prezzo Investco Ltd [2023] EWHC 1679 (Ch)*:

> *"68. The authorities also indicate certain factors that may be relevant to the exercise of discretion, including:-*
>
> *(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 (see Re Virgin*

Active Holdings Ltd at [266]; Re Houst Ltd at [27]; Re GAS Co. Ltd [2023] EWHC 1141 (Ch) at [110]);

(ii) the level of overall support for the plan is relevant, although not decisive (Re DeepOcean at [53]-[61]; Re Virgin Active at [259]-[300]; Re AGPS Bondco Plc at [66] to [67]);

(iii) whether the plan provides for a fair distribution of the benefits of the restructuring is relevant to the exercise of discretion (see, for example Re Virgin Active at [256]-[300]; Re Houst Ltd at [29])…;

(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 (Re Houst Ltd at [30]);

(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 (see Re DeepOcean at [64]; Re Houst Ltd at [31]); and

(vi) creditor non-opposition to sanction will be a relevant factor for the Court to take into account in the exercise of its discretion (see Re ED&F Man at [39]; Re Houst at [42]).”

Perhaps in time this list will cease increasing and instead be distilled into a definitive ‘fairness’ test, but without Parliamentary intervention this could just be wishful thinking. The Plan was designed to be a more flexible restructuring tool. To date, we have seen it successfully provide for the injection of new super-senior secured funding, the compromise of preferential HMRC debt, and the reordering of unsecured creditor claims *inter se*. These actions can be controversial as a matter of insolvency law, and as the Plan continues to evolve and be used in new and creative ways to achieve a desired restructuring, and as Plan opponents become more familiar with the procedure for challenge, the need for a consistently clear and predictable cross-check of fairness from the Court will surely become even greater.

This article first appeared in Corporate Rescue & Insolvency (2023) 6 CRI 199.

FURTHER READING

S. Paterson, ‘*Judicial Discretion in Part 26A Restructuring Plan Procedures*’ (January 24, 2022)

R. Mokal, ‘*The Court’s Discretion in Relation to the Pt 26A Cram Down*’ (2021) 1 JIBFL 12

LexisPSL: Restructuring and Insolvency: Practice Note: Cross-Class Cram Down under a Pt 26A Restructuring Plan

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