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# A new option for financially distressed companies: the new restructuring plan

Our practical guide to this new option compared to a CVA and a scheme of arrangement

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# A new option for financially distressed companies: the new restructuring plan

For many years, a financially distressed company unable to agree a consensual restructuring with its key creditors had only two formal options available to it under English law as part of seeking to survive as a going concern: a scheme of arrangement (a 'scheme') or a company voluntary arrangement (a 'CVA').<sup>1</sup>

A third option was recently added, in the form of a rescue and reorganisation procedure (a 'restructuring plan' or 'plan') under the Corporate Insolvency and Governance Act 2020 ('CIGA'), which came into force on 26 June 2020.

At first sight, these three different restructuring tools have a lot in common. Each of them:

- is a 'debtor in possession' process;
- enables a company to reach some kind of compromise with its creditors without needing the support of all creditors;
- uses 75% in value as the key threshold of creditor support that is needed<sup>2</sup>; and
- entails a public declaration of financial difficulties (albeit at the same time as proposing a solution).

There are, however, fundamental differences between each of the three options.

The restructuring plan has more in common with a scheme than a CVA, although it is available only as a means of addressing a company's financial difficulties, whereas a scheme has broader uses, including in circumstances in which there is no financial distress. The key feature of the restructuring plan that sets it apart from a scheme is the so-called cross-class cram down, which is explained below.

In the table below we have set out a comparison of the key features and practical uses of each of these options.

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<sup>1</sup> We are excluding for these purposes a pre-packaged insolvency sale (a common means of achieving a restructuring) on the basis that it entails at least one company in a group entering a formal insolvency proceeding and at the end of which it ceases to exist as a legal entity.

<sup>2</sup> Each process can be used to compromise the rights of shareholders, but this note focuses only on proposals affecting creditors.

	CVA	Scheme of Arrangement	Restructuring Plan
<b>Introduction</b>			
1. Recent examples	Pizza Express; New Look; Travelodge; Pizza Hut.	Instant Cash Loans; Noble group; Metinvest; DTEK.	Virgin Atlantic Airways (the only example of a sanctioned restructuring plan at the time of writing); Pizza Express (convening hearing held on 30 September 2020).
2. In a nutshell	<p>A well-established statutory procedure that allows a company to reach a compromise with some or all its unsecured creditors.</p> <p>A CVA, if approved by the requisite majority of unsecured creditors (who vote as a single class), binds all unsecured creditors and is implemented under the supervision of an insolvency practitioner.</p> <p>Intended as a relatively quick and easy means for any company to address its financial difficulties at an early stage, it has mostly been used in recent times to compromise lease liabilities (the so-called 'landlord only' CVA).</p>	<p>A well-established statutory procedure that allows a company to reach a compromise with its creditors or any class (or classes) of creditors.<sup>3</sup></p> <p>Creditors are divided into classes based on the similarity or otherwise of their rights both before the scheme (looking at their rights should the scheme not be implemented, including what those rights may be should the company enter a formal insolvency process) and following the implementation of the scheme.</p> <p>A class will be taken to have approved the scheme provided the requisite majorities of such class vote in favour of it. Each class must approve the scheme. If they do, the scheme is then subject to sanction by the court. If the scheme is sanctioned by the court it will bind every member of each class, irrespective of whether they voted for or against the scheme or did not vote at all.</p> <p>The process involves two court hearings as well as the meeting(s) of creditors. The associated professional costs mean that this is not a viable option for all companies.</p>	<p>A new restructuring tool similar in form to a scheme. Unlike a scheme, a restructuring plan can only be proposed where the company has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect its ability to carry on business as a going concern.</p> <p>As with a scheme, creditors<sup>4</sup> are divided into classes based on the similarity or otherwise of their rights both before the restructuring plan (looking at their rights should the plan not be implemented, including what those rights may be should the company enter a formal insolvency process) and following the implementation of the plan.</p> <p>The key novel feature is that a restructuring plan can be imposed on creditors without each class necessarily voting in favour of it, provided that at least one class does approve the plan and the 'relevant alternative' condition is satisfied (the so-called 'cross-class cram down' that we explain further below).</p> <p>As with a scheme, the process involves two court hearings as well as the meeting(s) of creditors. The associated professional costs mean that this is unlikely to be a viable option for all companies.</p>

<sup>3</sup> A scheme can also be used to compromise the rights of shareholders, but this note focuses only on creditor schemes.

<sup>4</sup> As with schemes, a restructuring plan can also be used to compromise the rights of shareholders, but this note focuses only on creditor plans.

	CVA	Scheme of Arrangement	Restructuring Plan
3. What it enables a company to do (according to the words in the legislation)	A composition in satisfaction of a company's debts or a scheme of arrangement of its affairs.	A compromise or arrangement between the company and its creditors, or any class of them.	A compromise or arrangement between the company and its creditors, or any class of them, the purpose of which is to eliminate, reduce or mitigate the effect of the company's financial difficulties.
4. Uses in practice	<p>In recent times, CVAs have mostly been used by retailers or casual dining businesses to compromise lease liabilities.</p> <p>CVAs have also been used for broader debt restructurings (e.g. Iona Energy).<sup>5</sup></p> <p>A key limit on the usefulness of a CVA for a distressed debtor is that it cannot be used to compromise the rights of a secured creditor against its will.</p>	<p>Wide and varied uses including: 'amend and extend' deals; to address regulatory capital issues; and full-blown corporate and debt restructurings of secured and unsecured debt.</p> <p>The compromise or arrangement could be about anything that the company and its creditors (or any class of them) may properly agree on among themselves, provided that it is sanctioned by the English court.</p>	As with schemes, plus the potential use of imposing a restructuring on a dissenting class of creditors using the cross-class cram down.
5. Relevant legislation	Part 1 of the Insolvency Act 1986.	Part 26 of the Companies Act 2006.	Part 26A of the Companies Act 2006 (introduced by Section 7 and Schedule 9 of CIGA).
<b>Eligibility</b>			
6. Does the company need to be insolvent to be eligible?	<p>No specific requirement.</p> <p>But, in practice there must be a real risk of insolvency in order to persuade creditors to vote for the proposed arrangement.</p>	<p>No specific requirement.</p> <p>But, in practice there must be a real risk of insolvency in order to persuade creditors to vote for a scheme that compromises their rights.</p>	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.
7. Available to all UK incorporated companies?	Yes, but only companies incorporated in England and Wales or Scotland (please note that Northern Ireland has its own form of CVA).	Yes.	Yes, subject to meeting the 'financial difficulty' condition outlined in part 2 above. The Secretary of State may, by Regulation, exclude companies from the scope of Part 26A of the Companies Act 2006, including those providing financial services.

<sup>5</sup> CVAs have also been used as more cost-effective means of distributing value to creditors than liquidation (which is, by definition, not part of achieving survival as a going concern).

	CVA	Scheme of Arrangement	Restructuring Plan
8. Available for use by an overseas company?	Yes, a CVA may be used by: <ul style="list-style-type: none"> <li>— a company incorporated in a member state of the European Economic Area ('EEA') other than the UK; or</li> <li>— a company not incorporated in an EEA state but having its centre of main interests ('COMI')<sup>6</sup> in an EEA state other than Denmark.</li> </ul>	Yes, any company liable to be wound up under the Insolvency Act 1986 (which, broadly speaking, requires a sufficient connection to the UK; this is a lower threshold than a requirement that a company's COMI be situated in the UK – see further discussion of COMI in part 10 below).	Yes, as with a scheme, any company liable to be wound up under the Insolvency Act 1986.
9. Can a creditor propose it?	No.	In theory yes, but not seen in practice, as it is unlikely that a creditor would have all of the information required in order to propose a scheme.	In theory yes, but unlikely in practice (for the same reason that applies to schemes).
<b>Recognition overseas</b>			
10. Automatic recognition across the European Union?	Yes. Where a company's COMI is in the United Kingdom, a CVA will be 'main proceedings' under the Recast Insolvency Regulation <sup>7</sup> and will, at the time of writing (before Brexit), benefit from automatic recognition in all EU member states.  A separate question is whether a CVA can be used to compromise rights governed by local law. Local law advice would be needed.	No <sup>8</sup> . The question of recognition outside the UK and the effectiveness generally of a scheme beyond the UK are issues that must be considered separately, with local legal advice. There is, however, plenty of precedent for English law schemes being recognised in other jurisdictions.  See comments adjacent on the restructuring plan regarding creditors' rights under local law.	No. But, as with schemes, the expectation is that a restructuring plan will be capable of having international effect and could be recognised in other jurisdictions.

<sup>6</sup> COMI means Centre of Main Interests, which in practice is the place where a debtor conducts the administration of its interests on a regular basis as ascertainable by third parties.

<sup>7</sup> Regulation (EU) 2015/848 on insolvency proceedings (recast).

<sup>8</sup> There has not been a definitive decision as to whether the Recast Brussels Regulation (Regulation (EU) 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast)) applies to schemes and plans; if it did, there would be recognition.

	CVA	Scheme of Arrangement	Restructuring Plan
<b>Role of court</b>			
11. Is there a court hearing?	<p>No.</p> <p>Although there is no hearing, certain papers must be filed at court.</p>	<p>Yes, two. These are:</p> <ol style="list-style-type: none"> <li>1. the convening hearing – to consider class composition and other jurisdictional issues and application for leave to convene class meeting(s) of creditors to consider the scheme; and</li> <li>2. the sanction hearing – to consider a request to sanction the compromise or arrangement (having been approved at the creditors’ meeting(s)).</li> </ol>	<p>Yes, two, as with a scheme.</p>
12. How much scrutiny is there by the court?	<p>None unless the proposed arrangement is challenged – see 13 below.</p>	<p>The judiciary has sent a clear message in recent years that schemes are not commoditised products and a company proposing a scheme can expect to have material aspects of a proposed scheme scrutinised by the court.</p> <p>These include jurisdiction and class composition as well as any consent fee arrangements and similar issues. Further, the court must satisfy itself that the scheme is fair and reasonable. That said, the court has tended to take comfort in the fact that creditors are usually the best judges of their own commercial interests. The court therefore focuses on whether there are any ancillary motives for the statutory majority of each class that has voted in favour of the scheme, and whether the scheme is one that a creditor could have reasonably approved.</p>	<p>As with a scheme.</p> <p>In addition, the court will have the ability to sanction a restructuring plan where there is a dissenting class (the cross-class cram down). If the two necessary conditions for a cross-class cram down (see below under ‘Cross-Class Cram Down’) are satisfied, it is unclear to what extent the court will apply any ‘fair and reasonable’ test, as it would in relation to classes which have approved the plan.</p>

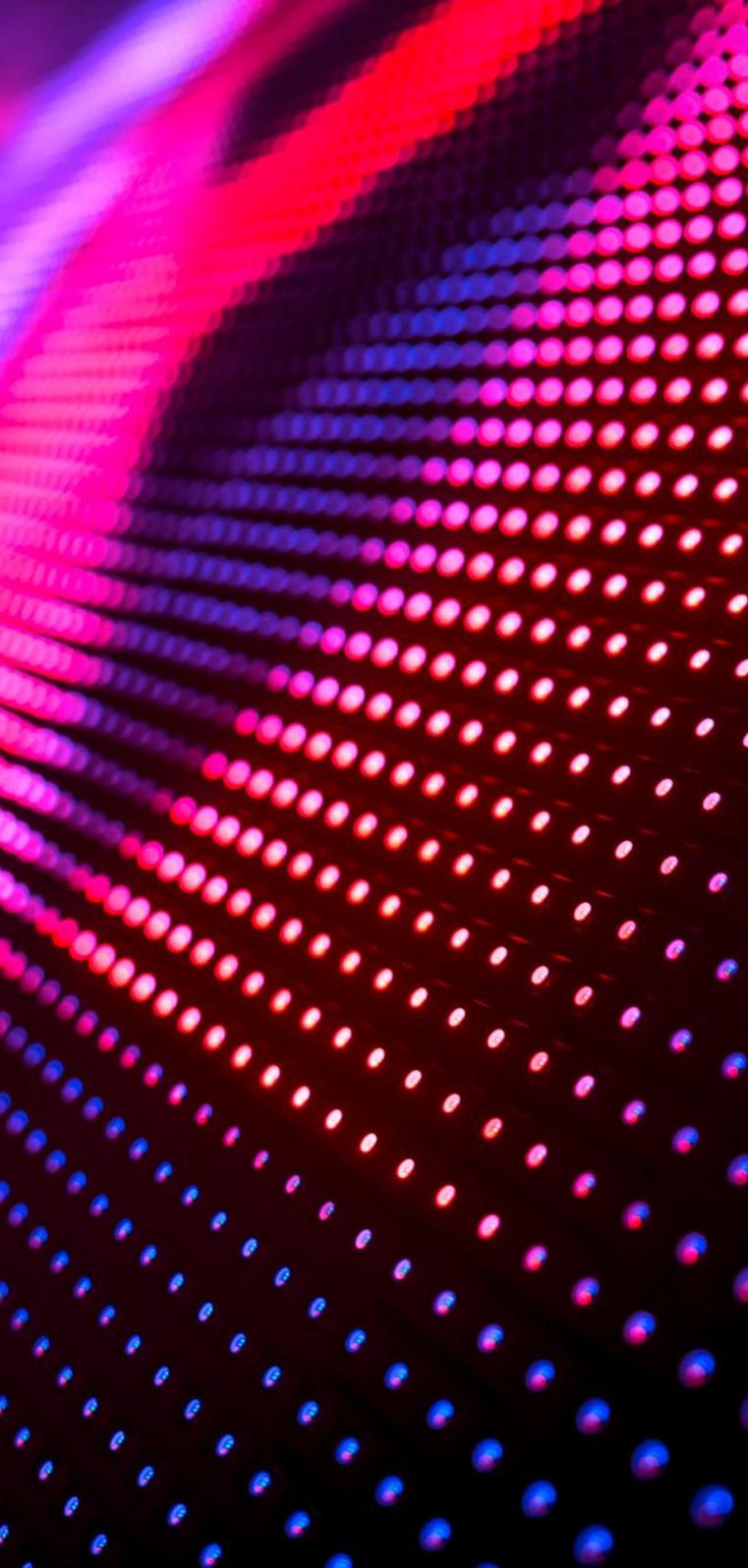
	CVA	Scheme of Arrangement	Restructuring Plan
13. Can the creditors' decision to approve a proposal be appealed?	<p>Yes.</p> <p>There is a specific 28-day period that starts when the result of the creditors' vote is reported to (filed at) court, during which a creditor may apply to court to challenge the CVA. A challenge may be brought on two grounds: (i) material irregularity; and/or (ii) unfair prejudice.</p>	<p>Yes.</p> <p>Dissenting creditors can challenge the scheme at the sanction hearing. Further, issues relating to jurisdiction and class composition can be raised at the convening hearing.</p> <p>Sanction judgments are rarely appealed.</p>	<p>Yes.</p> <p>See adjacent for practical experience with schemes. It remains to be seen whether the inclusion of the cross-class cram down, as a new concept, will result in a more protracted sanction stage, or more frequent appeals of sanction judgments.</p>
<b>Voting and level of support needed</b>			
14. Do all creditors vote?	<p>All creditors are entitled to vote save for secured creditors (who have the right to vote only to the extent that that secured creditor's claim is unsecured) and preferential creditors.</p> <p>Secured creditors and preferential creditors cannot have their claims compromised by a CVA unless they agree to as much.</p>	<p>No, only those creditors whose rights are affected by the compromise or arrangement vote on the scheme (and must be permitted to do so).</p>	<p>No, only those creditors whose rights are affected by the compromise or arrangement may vote on the restructuring plan (and must be permitted to do so).</p> <p>Also, Part 26A expressly provides that a court may exclude a class of creditors whose rights are affected where it is satisfied that none of the members of that class has a genuine economic interest in the company.</p>
15. What level of support is needed?	<p>75% by value of the company's unsecured creditors who respond in the decision procedure, unless those voting against it include more than 50% by value of all the unconnected creditors admitted for voting.</p>	<p>Each class must approve the scheme. For a class to approve a scheme, 75% in value and a majority by number of the creditors present and voting (in person or by proxy) must approve the scheme.</p>	<p>For a class to approve a restructuring plan, 75% in value of the creditors present and voting (in person or by proxy) in each class must vote in favour. There is no numerosity requirement, which distinguishes it from a scheme.</p> <p>If not all classes have approved the plan, the court may still sanction a plan if certain conditions are met, as explained further below under heading 'Cross-Class Cram Down'.</p>

	CVA	Scheme of Arrangement	Restructuring Plan
<b>Moratorium for company?</b>			
16. Does the company benefit from a moratorium on creditor action pending approval of the proposal?	<p>No.<sup>9</sup></p> <p>But a company may be able to benefit from the new so-called ‘pre-insolvency moratorium’, introduced by CIGA, to protect itself against creditors pending approval of the CVA. A separate process is required to obtain such a moratorium. See below under ‘New Pre-Insolvency Moratorium’.</p> <p>It is also possible that a company could be put into administration in the UK – to benefit from an administration moratorium – in order to propose a CVA and to exit from administration once the CVA has been approved. However, this is unlikely to be viable for most businesses.</p>	<p>No.</p> <p>But, as with a CVA, a company may be able to obtain a moratorium as a first step before launching a scheme proposal. That is a separate process.</p> <p>It is also possible that a company could be put into administration in the UK – to benefit from an administration moratorium – in order to propose a scheme and to exit from administration once the scheme has been sanctioned. However, this is unlikely to be viable for most businesses.</p>	<p>No.</p> <p>But, as with a CVA and a scheme, a company may be able to obtain a moratorium as a first step before launching a restructuring plan proposal. That is a separate process.</p> <p>As with a scheme, it is also possible that a company could be put into administration in the UK – to benefit from an administration moratorium – in order to propose a restructuring plan and to exit from administration once the plan has been sanctioned. However, this is unlikely to be viable for most businesses.</p>
<b>Timeline</b>			
17. Typical timeline	At least 42 days between launch date and expiry of the 28-day challenge period mentioned above plus prior preparation time.	At least 6 to 8 weeks from launch. Preparation time will vary, and tends to be longer than the process following the formal launch of the scheme.	As with a scheme. The only completed example to date, the Virgin Atlantic restructuring plan, was proposed and considered on an urgent basis, and took just over 7 weeks from launch (excluding preparation time).

<sup>9</sup> The CVA ‘small company moratorium’, under which a small company proposing a CVA could obtain a 28-day moratorium, was repealed by CIGA.

	CVA	Scheme of Arrangement	Restructuring Plan
<b>Advantages and disadvantages<sup>10</sup></b>			
18. Advantages	<p>Can be a relatively quick process.</p> <p>Generally less expensive (in professional fees) than a scheme or restructuring plan.</p> <p>No court hearings (unless challenged).</p> <p>A single vote of all unsecured creditors, without classes (this can help or hinder, depending on the circumstances).</p> <p>Automatically recognised in all EU member states (pending Brexit).</p> <p>Reasonably flexible as to the kind of 'composition' that can be offered in satisfaction of debts.</p>	<p>Can have less of a stigma than a CVA or a restructuring plan (as it is not strictly speaking an insolvency process or characterised by any qualification that the company be financially distressed).</p> <p>Can be used to achieve a compromise with secured and/or unsecured creditors.</p> <p>Very flexible as to the kind of compromise that can be achieved.</p> <p>Court sanction provides a degree of certainty.</p> <p>Can be used for overseas companies with relatively little connection to the UK.</p>	<p>Cross-class cram down gives a restructuring plan an advantage over a scheme if the company does not have requisite support of a class of creditors it wants to compromise.</p> <p>Unlike a scheme, the numerosity test need not be met in addition to the 75% threshold test (see 15 above).</p> <p>Can be used to achieve a compromise with secured and/or unsecured creditors.</p> <p>Very flexible as to the kind of compromise that can be achieved.</p> <p>Court sanction provides a degree of certainty.</p> <p>Can be used for overseas companies with relatively little connection to the UK.</p>
19. Disadvantages	<p>No moratorium to protect the company against creditor action pending approval.</p> <p>Cannot be used to compromise the rights of secured creditors (or preferential creditors); accordingly, tends to be used to compromise trade creditors and landlords rather than a wholesale financial restructuring.</p> <p>A single vote of all unsecured creditors without classes (per comment in 18 above).</p> <p>Generally seen as a very public declaration of insolvency/financial distress.</p> <p>The 28-day period for challenging the decision to approve a CVA does give rise to a degree of uncertainty during that period.</p>	<p>No moratorium to protect the company against creditor action pending approval.</p> <p>A relatively cumbersome and expensive process (with two court hearings as well as the creditors' meeting(s)).</p> <p>Court hearings provide a ready-made forum for creditors to challenge/take a public position (as opposed to a CVA, where a creditor must initiate proceedings to challenge the CVA).</p> <p>Not automatically recognised overseas; needs separate assessment.</p>	<p>As with schemes; plus, to be eligible, a company must meet the 'financial difficulty' condition (which may, however, be relatively easy to satisfy in practice).</p>

<sup>10</sup> We have set out what tend to be the advantages and disadvantages of each process. The weight attached to each point will of course depend on the particular circumstances.



### **New Pre-Insolvency Moratorium**

CIGA introduced a new option for a company of obtaining a short statutory moratorium to give it time to formulate a rescue plan, which may include seeking to use a scheme, a CVA or a restructuring plan.

The moratorium is similar to that which applies when a company is in administration in the UK: it prevents the enforcement of security, the commencement of insolvency proceedings or other legal proceedings against the company and forfeiture of leases.

The moratorium lasts for an initial period of 20 business days with an ability to extend for a further period of 20 business days without needing creditors' consent, and with the possibility of further extensions of up to one year or more.

With certain key exceptions, the company will not have to pay debts falling due prior to the moratorium but will have to pay debts falling due during the moratorium.

The moratorium is obtained by filing relevant documents at court which include: a statement from the directors that in their view the company is or is likely to become unable to pay its debts; and a statement from a suitably qualified person (the 'monitor') that, in their view, it is likely that the moratorium would result in the rescue of the company as a going concern.

For more detail, see [https://www.cms-lawnow.com/ealerts/2020/07/corporate-insolvency-and-governance-act-2020?cc\\_lang=en](https://www.cms-lawnow.com/ealerts/2020/07/corporate-insolvency-and-governance-act-2020?cc_lang=en)

**This document is for general guidance only and does not constitute definitive advice. It is based on the law as at 8 October 2020.**

### **Cross-Class Cram Down**

This is the main new feature of the restructuring plan, which distinguishes it from a scheme.

It means that a company may be able to have a restructuring plan sanctioned by the court, so that it is then binding on all relevant creditors, notwithstanding that a class of creditors voted against it.

For a court to be able to sanction such a plan, two conditions must be satisfied:

1. First, the members of the dissenting class must be no worse off under the plan than they would be in the event of the relevant alternative. The 'relevant alternative' is whatever the court considers would be most likely to occur in relation to the company if the plan were not sanctioned. In most, if not all, cases, the company's position will be that the relevant alternative is formal insolvency and the company will put expert evidence (from a licensed insolvency practitioner) before the court to show that the dissenting creditors would receive a dividend via a formal insolvency which is lower (probably materially lower) than the payment or other financial package being offered under the proposed plan.
2. Second, at least one class who would receive a payment or would have a genuine economic interest in the company in the event of the relevant alternative must have voted in favour of the plan.

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