Virgin Active and New Look: A New Dawn for the Rescue Culture?

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Introduction

As companies emerge from the restrictions of lockdown brought about by the Covid-19 pandemic, many will be facing a period of rapid adjustment and have incurred significant debt, particularly to landlords. Many businesses have benefited from the breathing space afforded by moratoria on winding up petitions and forfeiture, as well as support such as the deferral of VAT and the suspension of business rates. As the clock ticks towards the end of those measures, the very recent High Court judgments of Zacaroli J in *Lazari Properties 2 Ltd v New Look Retailers Ltd* (*New Look*)[1] on 10 May 2021 and Snowden J in *Re Virgin Active Holdings Ltd* (*Virgin Active*)[2] will be welcomed by many businesses in financial difficulties and considering restructuring.

In both cases, certain landlords unsuccessfully challenged the restructuring of companies that had viable businesses but were in financial distress due to the impact of Covid-19. In *New Look*, Zacaroli J dismissed a challenge to the company voluntary arrangement (CVA) of New Look on grounds including unfair prejudice and a challenge to the court's jurisdiction where creditors are treated differently. The judgment contains a detailed analysis of when a CVA may be unfairly prejudicial to the interests of a creditor of the company.

In *Virgin Active*, Snowden J sanctioned the restructuring plans proposed by three *Virgin Active* companies, which were objected to by a group of landlords. This is a really important judgment on restructuring plans, which were introduced on 26 June 2020 by the Corporate Insolvency and Governance Act 2020, in particular on "cross-class cram down". Snowden J was satisfied that landlords would not be worse off than in the "relevant alternative" which was an accelerated sale of the business on a regional basis in administration; this was the only condition for cross-class cram down in issue. He also decided to exercise his discretion to sanction the plans.

For completeness, Zacaroli J also delivered judgment in the challenge to the CVA of the Regis company on 17 May 2021 in *Carraway Guildford (Nominee A) Ltd v Regis UK Ltd* (*Regis*).[3] He followed his earlier decision in *New Look*, although in *Regis*, the landlords succeeded in their challenge on the facts on a single ground of unfair prejudice due to the treatment of one particular creditor.

The judgments

There were some similarities in the facts of each of *New Look* and *Virgin Active*. In each case, some landlords complained that rent arrears were being released and future rent was also to be reduced. In *New Look*, some landlords were to receive "turnover rent" monthly in arrears, based on a fixed percentage of net sales. Significantly, in both cases, landlords had the option to terminate the lease—including enhanced rights to terminate for those landlords with the worst outcome on the changes to rent.

There were also similarities in some of the themes of challenge by the objecting landlords who sought to rely on what they said was the unfairness in rent reductions. In *New Look*, Zacaroli J pointed out that the practical reality was that future rent was lost as a consequence of New Look's insolvency and not forced on landlords (at [220]). In *Virgin Active*, Snowden J stated that the court does not simply impose its own views of what is or is not fair or just and equitable in exercising its discretion (at [221]).

The main difference between the lines of attack in each case was due to the inherent difference between restructuring plans and CVAs. In *New Look*, the landlords complained that the necessary 75% majority to approve the CVA was secured with votes of creditors who were treated differently from them. Of course, this cannot of itself be an objection in restructuring plans due to the court's power to sanction a plan notwithstanding that there are objectors within a class of creditors or members of the company who represent at least 75% in value of that class.

While the objecting landlords did not succeed on this point in *New Look*, in his judgment Zacaroli J stated (at [156]) that if a large number of creditors who were unaffected by the CVA led to the 75% majority being achieved this was a highly relevant factor in determining whether there is unfair prejudice. However, he took into account that the CVA was part of wider restructuring which included a scheme of arrangement under which the secured creditors' rights were impaired (at [245]).

[1] *Lazari Properties 2 Ltd v New Look Retailers Ltd* [2021] EWHC 1209 (Ch).
[2] *Re Virgin Active Holdings Ltd* [2021] EWHC 1246 (Ch).
[3] *Carraway Guildford (Nominee A) Ltd v Regis UK Ltd* [2021] EWHC 1294 (Ch).

Why was there no unfair prejudice in New Look?

Zacaroli J followed Norris J's landmark decision in *Discovery (Northampton) Ltd v Debenhams Retail Ltd*.[4] One of the decisive points in *New Look*, as in *Debenhams*, was that landlords had an option to terminate the leases. Zacaroli J agreed with this as a key factor in meeting a claim of unfair prejudice in *New Look* (at [214] and [221]). While different treatments of creditors did not make a CVA inherently unfairly prejudicial (at [170]), it is highly relevant in determining whether there is unfair prejudice. However, he also noted that different treatment of creditors was often essential for the rescue of a viable business (at [175]).

What are the conditions for cross-class cram down and how was this applied in Virgin Active?

The power of the court to sanction a restructuring plan to bind dissenting classes of creditors or members—also known as cross-class cram down—is a really significant feature of restructuring plans. Restructuring plans were introduced into the Companies Act 2006 Pt 26A by the Corporate Insolvency and Governance Act 2020 in June 2020 and are a real milestone for restructuring.

There are two conditions that have to be satisfied for cross-class cram down. In *Virgin Active*, it was common ground that the second of these—known as Condition B—was satisfied. Condition B is that:

> "the compromise or arrangement has been agreed by a number representing 75% in value of a class of creditors or (as the case may be) of members, present and voting either in person or by proxy at the meeting summoned under section 901C, who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative" (Companies Act 2006 s.901G).

The condition in issue was Condition A which requires the court to be satisfied that "none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative"; this is known as the "no worse off test". The court is required to consider what the "relevant alternative" is, which is defined as "whatever the court considers would be most likely to occur in relation to the company if the compromise or arrangement were not sanctioned under section 901F". In *Virgin Active*, Snowden J held that the relevant alternative was administration and that the administrators would pursue an accelerated sale of the business on a regional basis (at [197]). Snowden J considered whether each dissenting class would be worse off in that alternative and concluded they would not be as they would receive better returns under the restructuring plans (at [200]).

Discretion to sanction the restructuring plans

A wide range of issues were raised in *Virgin Active* as to the factors the court could and should take into account in exercising its discretion to sanction a restructuring plan. Snowden J agreed that it was inherent in the new cross-class cram down provision in restructuring plans under Pt 26A that the court should not be reluctant to differ from the vote at a class meeting (at [214]). He also stated that the court did not simply impose its views of what was "fair" or "just and equitable" in exercising its discretion (at [221]).

Snowden J also considered the issue of whether conceptually a plan could be sanctioned in which different treatment and substantial value is given to some but not all creditors who are "out of the money". Snowden J noted that in *DeepOcean*,[5] Trower J concluded that it could, being satisfied on the evidence that there were "good commercial reasons" for taking that course (at [260]). His view was that this could be a reason to decline to exercise discretion if the plan "discriminated arbitrarily or capriciously between different classes of unsecured creditors who were all equally out of the money" but he did not need to decide that on the facts of the case because the evidence as to the exercise by the directors of their commercial judgment was not challenged.

How will the restructuring market respond to these judgments?

The decision in *Virgin Active* has certainly brought home how useful restructuring plans can be as one of the options for any company in financial difficulties. *Virgin Active* does illustrate how a company operating across a number of sites, some of which are viable and others not, can benefit from the flexibility of a restructuring plan. Moving forwards, restructuring plans may start to be used more frequently by SMEs. Key considerations may be the cost of devising the plan, the greater control of the process by the court leading up to sanction and the likely longer lead in time to the sanction of the plan. In addition, the evidence on the "no worse off test" will always be bespoke and, as in *Virgin Active*, is likely to be extremely detailed and comprehensive.

Equally, it is possible that more complex companies may increasingly use CVAs in light of *New Look* although the test of unfair prejudice in a CVA is more nuanced than cross-class cram down. In addition, the challenge to the CVA happens after the approval of the CVA whereas in a restructuring plan the challenge takes place before the court's sanction, which can reduce uncertainty. As Zacaroli J noted in *New Look* (at [199]), one of the benefits of a restructuring plan from the perspective of creditors is that there is more time to negotiate and consult than there sometimes is with a CVA.

[4] *Discovery (Northampton) Ltd v Debenhams Retail Ltd* [2019] EWHC 2441 (Ch); [2020] B.C.C. 9.
[5] *Re DeepOcean 1 UK Ltd* [2021] EWHC 138 (Ch); [2021] B.C.C. 483.

The impact of the judgments in New Look and Virgin Active

Both the judgments of Snowden J in *Virgin Active* and Zacaroli J in *New Look* are likely to be very influential in restructuring. The ability to cram down dissenting creditors in restructuring plans is clearly going to have a growing impact on the restructuring of businesses in financial distress. The very detailed consideration by Snowden J in *Virgin Active* of how evidentially the cross-class cram down "no worse off" test operates and factors relevant to the exercise of the court's discretion will really build confidence in restructuring plans moving forwards.

The outcome of these cases may be seen as giving strong support for and signal a new dawn for the rescue culture at this very precarious and still uncertain time for many companies, their owners, employees and creditors. In both cases, there were viable businesses, which will emerge with strength following the restructuring.