KEY POINTS

- As Georgia has previously discussed in *Creditor democracy and class distinctions in solvent insurance company schemes of arrangement* (2010) 5 JIBFL 291 entry into a regular scheme of arrangement by a solvent company, albeit one "having a problem requiring a solution", could face several hurdles including the Buckley Test.
- The new Pt 26A scheme of arrangement, now commonly referred to as a Restructuring Plan, addresses the entry requirements in condition A: "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".
- Intercreditor Agreements are effective as a matter of English law to alter the *pari passu* principle of distribution on insolvency where one or more parties contractually agree to subordinate their interests to those of other creditors.
- The court has an absolute discretion to refuse to sanction a plan, including if the plan is not just and equitable.
- Do intercreditor agreements trump creditors' statutory rights in respect of Restructuring Plans? Will a court sanction a plan when significant dissenting creditors are being forced to vote in favour because of an intercreditor agreement entered into before Restructuring Plans entered the legal arena?

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Intercreditor agreements and the new Restructuring Plan

In this article the authors consider how the new Restructuring Plan under English law interacts with intercreditor agreements which have voting restrictions and other contractual prohibitions on creditor actions.

The introduction of the new Restructuring Plan tool into the Companies Act 2006 by way of the Corporate Governance and Insolvency Act 2020 has changed the English law restructuring landscape dramatically. Not only is cross-class cramdown now possible, but the new plan can be used for solvent companies facing financial difficulty as well as companies facing actual insolvency. They can also compromise secured creditors and so we expect them to replace CVAs for all but the most straightforward capital structures. Companies with more complicated capital structures will almost certainly find that their financial creditors have entered into an Intercreditor Agreement and may in fact have entered several different priority arrangements between different groups of creditors. These priority arrangements are likely to have voting restrictions and other contractual prohibitions on creditor actions.

This article focusses on voting arrangements and agreements to vote or refrain from voting in intercreditor agreements. In particular: (i) whether a contract to vote as directed by another class of creditor will separate or consolidate creditors into classes for Restructuring Plan purposes; and (ii) whether a court would grant an injunction to require a creditor to vote in accordance with an intercreditor agreement and/or take voting restrictions into consideration when sanctioning a plan. We also look at the US approach on these points given the UK government's reference to Chapter 11 and similar debtor-in-possession proceedings in its decision to establish Restructuring Plans.

RESTRUCTURING PLAN VOTING

The general principle under Pt 26A of the Companies Act 2006 is that every creditor whose rights are affected by a Restructuring Plan must be permitted to participate in the meeting summoned by the court to vote on the plan, subject to exceptions for any out of the money creditors or shareholders.

If there is an intercreditor agreement in place, this principle may be varied through contractual voting provisions. The intercreditor agreement will regulate the rights of the parties to take enforcement action which in many cases, including those that follow the LMA definition of enforcement action, will extend to regulating voting under a Restructuring Plan. However, it would be unusual for shareholders to be bound by an intercreditor agreement unless they have provided subordinated debt to the company.

It is relatively common that a fully subordinated creditor will be restricted in some way from taking enforcement action. Whether the controlling creditors have the power to direct how the other creditors will vote under a Restructuring Plan will depend on the terms of the intercreditor agreement and the definition of enforcement action.

The LMA senior/mezzanine intercreditor agreement includes an optional provision which gives the "instructing group" an express right to control voting, but it is an *optional* provision precisely because it could have far reaching consequences for the dragged creditors. For example, if the plan provides only minor compromises of the rights of the senior creditors but compromises the rights of the subordinated creditors more substantially, then it may appear to be manifestly unjust for the subordinated creditors' voting rights to be controlled in this way. The counter argument to this is the principle of freedom of contract.

Even if there is no specific contractual provision controlling how the affected creditors are required to vote, if a subordinated creditor cannot take enforcement action (ie vote on a plan) without the senior creditors' consent then the subordinated creditor will still be restricted. The senior creditor could condition its consent by specifying which way the subordinated creditor is required to

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vote, thereby imposing a contractual voting restriction on the subordinated creditor.

VOTING RESTRICTIONS AND CLASS COMPOSITION

Creditors whose rights are affected by a proposed plan are divided into classes and, as set out above, every creditor whose rights are affected is entitled to a vote. Will a contract to vote as directed by another creditor or group of creditors separate creditors into different classes for Restructuring Plan purposes? Or automatically result in their consolidation into a single class?

The principles of class composition for a Restructuring Plan closely follow those for schemes of arrangement. The essential principle is that a class "must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest".

Whether creditors whose rights are governed by an intercreditor agreement will be joined together in a single class will depend on the terms of the Restructuring Plan and whether the class composition test can be met. In the recently proposed Virgin Active Restructuring Plan, the landlords were split into five different classes depending on the treatment of their rights under the proposed plan, notwithstanding the fact that all the landlords had substantially similar *existing* rights against the Virgin Active plan companies. However, as those similarities as to existing rights were not reflected in the variation of rights proposed under the plan five separate landlord classes were formed.

In our view, it is unlikely that the mere fact that certain creditors have signed up to an intercreditor which includes contractual voting restrictions will affect class composition. It is arguable that a subordinated creditor who has signed away its voting rights does not have a "common interest" with the creditor who holds its votes and so it would be impossible for those creditors to consult together with a view to their common interest (and in fact no consultation would be required). However, it is hard to see how fracturing a class for this reason alone would make sense and, in any event, if the class was fractured this would not in and of itself affect the enforceability of any contractual voting restrictions.

REMEDIES

This leads us to what happens if a creditor who is contractually obliged to vote in a particular way does not do so.

While it is clear that the controlling creditor would have a breach of contract claim against the breaching creditor, the usual remedy of damages may not be an adequate remedy. If the controlling creditor supports the proposed plan but the votes of the breaching creditor are required to reach the 75% by value threshold, the controlling creditor could apply for an injunction to force the breaching creditor to vote as contractually agreed. This fact pattern is most likely to apply if the creditors form one class and that class approval is required so that the court's cram-down power can be invoked. Alternatively, similar to the US approach (discussed below), enforceability of a contractual voting restriction could be raised at the sanction hearing.

The court has a wide power to approve or reject a plan at the sanction hearing, and the court has made it very clear in the case of schemes of arrangement that this final step is not a rubber-stamping exercise. Whether the English courts will use this power to enforce or refuse to enforce contractual restrictions on voting, especially voting restrictions that were entered into before the Restructuring Plan was part of the legal landscape, remains to be seen.

THE US APPROACH

In contrast to the English jurisprudence, which is still limited, the US bankruptcy courts have frequently considered enforceability of restrictions on, and assignments of, voting rights by creditors under intercreditor agreements, and the related issue of waivers of bankruptcy rights by subordinated creditors under intercreditor agreements. Perhaps unsurprisingly given the complex issues involved, the case law on these points is inconsistent.

Under §510(a) of the US Bankruptcy Code a subordination agreement (which includes an intercreditor agreement) is enforceable in bankruptcy to the same extent as it would be enforceable outside of bankruptcy. This is analogous to the English law position. The right for a creditor to vote on a bankruptcy plan which affects its rights is a sacred right. Whether an intercreditor can upend this right by providing that a subordinated creditor assigns its right to vote to a more senior creditor is a question which at least some of the bankruptcy courts who have had to grapple with these issues have shown reluctance to overrule.

In 2015, a commission established by The American Bankruptcy Institute to Study the Reform of Chapter 11 recommended that voting waivers and assignments should not be enforceable under an intercreditor, subordination, or similar agreement. The ABI Commission concluded that it was generally uncomfortable with non-debtor parties having the ability to alter the rights of the debtor and other stakeholders using voting provisions and that such provisions give senior creditors too much power in the bankruptcy process. The LSTA issued a robust response to this recommendation, stating that it believes "that there is no reason for such a change, which departs from the basic bankruptcy principle of respecting parties' nonbankruptcy agreements, especially where – as here – both parties are nondebtors who made the agreement voluntarily and at arm's length": essentially upholding the freedom of contract principle.

A detailed analysis of the US case law is outside the scope of this article, but it is useful to note that these sorts of issues have arisen fairly frequently in the US. Given the stated modelling of the new Restructuring Plan on Chapter 11, it remains to be seen whether the enforceability of voting restrictions will be similarly challenged in Restructuring Plans in the future. ■

Further Reading:

- Creditor democracy and class distinctions in solvent insurance company schemes of arrangement (2010) 5 JIBFL 291.
- The impact of the Corporate Insolvency and Governance Act 2020 on drafting loan documentation and practice (2021) 4 JIBFL 273.
- LexisPSL: Checklists: Restructuring & Insolvency: Checklist of factors which may (or may not) fracture in a scheme of arrangement or restructuring plan.