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DEEPOCEAN: THE UK'S FIRST CROSS CLASS CRAM DOWN RESTRUCTURING PLAN

MARCH 2021

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On 28 January, the English High Court handed down the first ever judgment sanctioning a restructuring plan under Part 26A of the Companies Act 2006 ("**CA 2006**") ("**Plan**") invoking the new cross class cram down procedure introduced into UK law in June 2020.

Trower J's judgment in the DeepOcean restructuring has been highly anticipated, and is the first time the court has set out the matters it should take into account when considering whether to exercise its discretion to sanction a Plan against the wishes of a dissenting impaired class, thereby effecting a cross class cram down pursuant to its powers under section 901G of the CA 2006 (a "**Cram Down Plan**"). The court has only ever previously considered Plans that have not invoked the cross class cram down provisions.

In considering whether to exercise discretion in this case, Trower J started with the traditional tests applicable to the sanction of schemes of arrangement under Part 26 of CA 2006, namely:

1. whether the provisions of the statute have been complied with, including (in the context of a Plan) whether statutory conditions for cram down had been met;
2. whether the classes were fairly represented by the meetings;
3. whether the Plan was one which an "honest and intelligent man, acting in respect of his own interests" could approve; and
4. whether there was any "blot" or defect in the Plan.

However, unlike schemes of arrangement under Part 26 of CA 2006 ("**Schemes**"), where it is well established that "the court will be slow to differ from the meeting", under a Cram Down Plan the court is expressly asked to override the wishes of the dissenting class and therefore must take into account additional factors when considering whether to sanction a Cram Down Plan. Trower J stated that the starting point for this different approach can be found in the explanatory materials to the Corporate Insolvency and Governance Act 2020: the court will focus on the negative question of whether a refusal to sanction is appropriate on the grounds that the restructuring plan is not "just and equitable".

The negative formulation of this question is important – in Trower J's view it reflects the general proposition that the applicant company "will have a fair wind behind it" if it seeks an order sanctioning a Cram Down Plan over the wishes of a dissenting class where the relevant statutory conditions (see further below) have otherwise been met.

The additional factors that Trower J took into account when assessing whether the Cram Down Plan was not "just and equitable" were:

1. the economic interest of the dissenting class in the relevant alternative:
    a. in this case, dissenting class was out of the money and would receive nothing in the relevant alternative (whereas they were to receive benefits under the Plan);
    b. as they were out of the money, it would have been possible to exclude their vote altogether in a Scheme, using the established technique of binding senior creditors under the Scheme and using a pre-pack administration or enforcement sale to transfer the business and assets to a newco, leaving junior creditors behind;
    c. the benefits to be received by the dissenting class were to be provided by entities from the wider DeepOcean Group, not the Plan Companies;
2. the turnout and levels of support for the proposals across the different classes – in this case, two other classes of substantially similarly placed creditors approved the DeepOcean Plan; and
3. the relative treatment of creditors under the Plan (the so called "horizontal comparator" that has developed in cases challenging company voluntary arrangements ("**CVAs**") on the grounds of unfair prejudice) – in this case, the differential treatment of secured creditors and certain excluded creditors was justified.

In DeepOcean, the facts of the case led to the simple conclusion that the Cram Down Plan in this case was one that should be sanctioned by the court. However, the judgment provides the first useful indications of the framework the court will adopt when assessing more contentious Cram Down Plans – as expected, it is clearly an area where wide-ranging disputes between competing classes of creditors (and shareholders) are likely to arise in future cases.

As is demonstrated in the US Chapter 11 context, we anticipate that whilst the court will occasionally be asked to sanction contested Cram Down Plans amidst heated and expensive inter-creditor disputes, it will be the threat of cram down during restructuring negotiations that will have the most impact on the UK restructuring framework.

The background to the DeepOcean restructuring plan and further analysis of Trower J's judgment is set out in more detail below.

Background

The DeepOcean Group is a provider of subsea services to the offshore industry principally focussed on the oil and gas and offshore renewable sectors. The purpose of the restructuring was to effect a solvent wind down of the group's unprofitable cable laying and trenching business operated out of DeepOcean I UK Limited ("**DO1**"), DeepOcean Subsea Cables Limited ("**DSC**") and Enshore Subsea Limited ("**ES**") (the "**Plan Companies**" and the "**CL&T Group**"), each incorporated in England and Wales with their centre of main interests in the UK. The Plan Companies proposed a Plan to restructure their debt and to prepare the way for their solvent wind down (the "**DeepOcean Plan**").

Trower J had confirmed at the convening hearing for the DeepOcean Plan that Plans may be used to implement an orderly wind down, in the same way that Schemes have been used by liquidators to compromise liabilities to ensure an orderly wind down with a better outcome for creditors.

Evidence was provided to the Court that the relevant alternative to the DeepOcean Plan was a liquidation of the CL&T Group, and a detailed entity priority model produced by the Plan Companies' financial advisor indicated that the Plan Companies' unsecured trade creditors (the "**Other Plan Creditors**") would receive a zero return in a CL&T Group insolvency scenario compared with an approximately 4% distribution in the DeepOcean Plan, to be funded by other members of the DeepOcean Group. The CL&T Group's secured financial creditors were likely to receive a small distribution in the CL&T Group insolvency scenario.

The DeepOcean Plan was agreed by the statutory majority in value at each of the meetings summoned by DO1 and ES. DSC had called meetings of two classes of creditors: the DSC secured creditors and the DSC Other Plan Creditors. The statutory majority in value was met at the meeting of DCS's secured creditors but not at the meeting of its Other Plan Creditors, at which only 64.6% present and voting at the meeting had voted in favour. The statutory voting thresholds for sanction of the DeepOcean Plan were therefore not satisfied, and the Court had to consider whether it could exercise its jurisdiction under section 901G of CA 2006 to override the decision of the DSC Other Plan Creditors and sanction the DeepOcean Plan.

The law

Similar to Schemes, both English-incorporated and foreign-incorporated companies are able to propose a Plan. However, unlike Schemes, the Court will only have jurisdiction to sanction a Plan if:

1. the applicant company is experiencing financial difficulties that are affecting or may affect the company's ability to carry on business as a going concern; and
2. the purpose of the Plan is to eliminate, reduce or prevent or mitigate the effect of those financial difficulties.

Pursuant to section 901F of CA 2006, 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, agree a compromise or arrangement, the court may sanction the compromise or arrangement.

This statutory voting threshold is subject to section 901G of CA 2006, which makes clear that the court has the discretion to sanction a Cram Down Plan, overriding the views of a dissenting class, where it is satisfied:

1. members of the dissenting class will be no worse off than they would be in the "relevant alternative" (i.e. whatever the court considers would be most likely to occur in relation to the company if the compromise or arrangement were not sanctioned) ("**Condition A**"); and
2. the Plan is approved by at least one class of creditors who would have a genuine economic interest in the relevant alternative

("**Condition B**").

As is the case with Schemes, the legislation is silent on how the Court should exercise that discretion, leaving the Court to develop the law in that regard.

The test for exercising the Court's discretion to sanction

In DeepOcean, Trower J held that the well-established approach used for Schemes would be a good starting point in determining the relevant factors to take into account when deciding whether to sanction a Cram Down Plan, but whilst several aspects of the approach remain applicable, some modification was necessary.

As noted above, Trower J looked to and appeared to adopt the guidance set out in the Explanatory Notes to the Corporate Insolvency and Governance Act 2020 (the implementing legislation which introduced Plans into the CA 2006), which indicate that, in addition to considering the well-established principles that apply to Schemes, the court may also refuse to sanction a Cram Down Plan where it would not be "just and equitable" to do so, even if the statutory conditions to cram down had been met.

This is a new approach for the court, as it does not presently consider whether a Scheme is "just and equitable" in determining whether to sanction it, but whether the Scheme is fair in accordance with the view of the honest and intelligent member of the class.

As noted above, in addition to the usual considerations relevant to the sanction of a Scheme, Trower J placed emphasis on three further factors going to the Court's discretion:

1. the economic interest of the dissenting class in the relevant alternative;
2. the turnout and levels of support for the proposals across different classes (and in particular, similarly placed classes); and
3. the relative treatment of creditors under the Plan (the "horizontal comparator").

Has the statute been complied with?

As with Schemes, the first step for the court will be to consider whether the statutory provisions have been complied with:

1. the plan company must satisfy the court at the convening hearing that it has met the section 901A conditions to propose a Plan i.e. that it 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; and that the plan is a compromise or arrangement proposed with its creditors or any class of them, the purpose of which is to eliminate, reduce or prevent or mitigate the effect of the financial difficulties. It is not appropriate for the court to reopen the issue of whether the section 901A conditions have been met at sanction stage where the court has reached a reasoned decision on the point and no party has sought to argue against the conclusion;
2. it is generally not appropriate to revisit the issue of class constituencies at sanction where no material developments in that regard have occurred since the convening hearing. However, in the context of a Cram Down Plan, the court may consider whether there was artificiality in the creation of classes that would cause it to revisit the conclusion that it reached on classes at the convening hearing;
3. the court will consider whether the terms of the convening order have been complied with, the form of the explanatory statement, and whether the statutory majorities are met; and
4. where a class's vote has not met the statutory majority, the Court must consider whether Conditions A and B of section 901G (set out above) have been met.

Relevant Alternative

Identifying the relevant alternative is similar to the exercise of identifying the appropriate comparator for class purposes in the context of a Scheme (i.e. the court will look at the realistic alternative to the Plan, the position that would apply if the Plan were not to proceed). This will not always be insolvency, but could be a solvent run off or wind down, or an expedited sales process of business and assets. It is also similar to an exercise which the court may be called on to carry out when applying a "vertical" comparison for the purposes of an unfair prejudice challenge to a CVA (i.e. comparing the projected outcome of the CVA with the projected outcome of a realistically available alternative process, and setting a "lower bound" against which to assess the proposed CVA).

There may be a case where identifying the relevant alternative is difficult and questions of some complexity will arise as to the financial consequences of that counter-factual for some or all of the plan creditors. This was not such a case.

Meaning of "worse-off"

When considering what makes a creditor "worse off" when determining if section 901G Condition A has been met, the starting point will normally be the comparison of the value of the likely dividend, or the amount of any discount to the par value of each creditor's debt.

However, Trower J acknowledged that "worse off" is a broad concept and appears to contemplate the need to take into account the impact of the Plan "on all incidents of the liability to the creditor concerned", including matters such as timing of any payments and the security of any covenant to pay (i.e. the likelihood of payment). This appears to suggest that the court may go beyond a simple comparison of "day 1" economics arising from a Plan versus the "relevant alternative", and may look further into the future when assessing whether a dissenting class may be "worse off".

It was relatively straightforward in this case to establish that not only would no member of the dissenting class be worse off, but also that each of them would clearly be better off. In particular, the evidence before the court clearly established that they would receive nothing in the relevant alternative (whereas they were to receive benefits under the Plan).

Section 901G Condition B was easily satisfied, given DSC's secured creditors had voted in favour of the Plan and would make a small recovery out of the charged assets in the relevant alternative, sufficient for them to have a genuine economic alternative.

Does the Plan treat the dissenting class in a way that is not just and equitable?

Trower J noted that the legislation and the Explanatory Notes indicate that "an applicant company will have a fair wind behind it if it seeks an order sanctioning a [Plan] notwithstanding a dissenting class where the section 901G conditions A and B are met". The Explanatory Notes suggest that, "where that is the case, the court will focus on the negative question of whether a refusal to sanction is appropriate on the grounds that the [Plan] is not just and equitable." This reflects a recognition that, if the statutory requirements are met, and no other factors are in play, the dissenting class's rights will have been varied in a manner which can only have had a neutral or better impact for them. The focus will therefore not be on the positive question of why justice and equity point to the plan being sanctioned.

Economic interest

In this case, Trower J considered the following as highly relevant to the question of whether or not the DeepOcean Plan was just and equitable:

1. the dissenting class was out of the money and would receive nothing in the relevant alternative (whereas it was to receive benefits under the DeepOcean Plan);
2. as they were out of the money, it would have been possible to exclude their vote in a Scheme, using the established technique of binding senior lenders under the Scheme and using a pre-pack administration or enforcement sale to transfer the business and assets to a newco, leaving junior creditors behind; and
3. the benefits to be received by the dissenting class were to be provided by entities from the wider DeepOcean Group, not the Plan Companies.

He held that a receipt of any benefits by the dissenting class in circumstances where they were out of the money in the relevant alternative, and where it would have been possible to exclude them in a Scheme, meant that they were unlikely to have been treated in a manner that is not just and equitable. This, combined with the fact that the benefits to be received by the DSC Other Plan Creditors were provided from sources outside the Plan Companies, was a "powerful pointer" towards sanctioning the Plan.

Finally on this point, in an obiter comment, Trower J noted it may be possible to disenfranchise a creditor class that is out of the money under section 901C(4), where creditors who do not have a genuine economic interest in the company can be left out of the vote entirely. This gives some support to our view set out in our article in June 2020 that the Restructuring Plan regime gives an apparent ability to alter (or even cancel) the rights of a completely out of the money class (which can be a creditor or shareholder class or indeed multiple classes) without allowing them to vote on the Restructuring Plan at all.

Turnout and representation

The overall support for the Plan Companies' proposals together with the question of whether the plan creditors were fairly represented at their respective plan meetings will be material questions when assessing the justice of the proposed Plan. They inform the court as to the weight to be given both to the views of the class meetings which have agreed the Cram Down Plan, and the views of the dissenting class.

It is established law that a low turnout at a meeting which has agreed a Scheme or a Plan is capable of undermining the conclusion that the vote was representative of the class concerned, particularly where creditors were unable to engage rather than chose not do so. Trower J concluded that, likewise, a low turnout at a dissenting class meeting may also affect the question of how much weight is to be given to the dissentients' vote.

That is to say, as was apparently the case in the DeepOcean restructuring, where the evidence establishes that the members of the relevant class had sufficient opportunity to engage in the process, but chose not to do so (for example, because a substantial number of them held relatively immaterial claims and were disinterested in the outcome of the proposal), then the court may place less weight on the dissenting votes of those members of the class that did so engage.

A very relevant, but possibly somewhat unique, factor in the DeepOcean case was that:

1. there were three separate classes of Other Plan Creditors, one for each of DO1, ES and DSC, who were all similarly placed and were to receive substantially the same treatment under the DeepOcean Plan;
2. the only reason these three separate classes were not placed in a single class was that their claims were against three separate legal entities; and
3. in the aggregate, just under 84% of those Other Plan Creditors voted in favour of the DeepOcean Plan, and just over 16% voted against.

Trower J concluded that this, combined with the relatively high overall turnout and support for the DeepOcean Plan from all other creditor classes, supported the conclusion that it was open to an intelligent and honest man to vote in favour of the DeepOcean Plan. This was another factor relevant to assessing whether or not the Plan was "just and equitable".

Trower J also noted that:

1. while the turnout at the Other Plan Creditors meetings was relatively low, it was relevant that they were primarily trade creditors such as suppliers, and a lower turnout was therefore not particularly surprising;
2. there was nothing to suggest that any plan creditor had been unable to engage by participating at the relevant meeting, as opposed to simply choosing not to do so;
3. there was no evidence that any creditor was influenced in the way it cast its vote by any collateral interest; and
4. there was no evidence that the consideration of the matter by any other of the plan creditors was carried out by any of them other than honestly and in good faith with a view to the interests of the class which they were empowered to bind.

Relative treatment - the horizontal comparator

The relative treatment of creditors under the proposals will be a discretionary factor that may apply and has much in common with the "horizontal comparator" carried out by the court when considering an unfair challenge to a CVA, whereby differential treatment between creditors must be justified. The context of the horizontal comparator in a CVA is that all voting creditors are unsecured, and not separated into classes.

In Trower J's view, because a class' right of veto is removed by the operation of section 901G, justice may require the court to look at questions of horizontal comparability to determine whether the difference in treatment of creditors inter se in a Cram Down Plan is justified. In particular the court will be concerned to ascertain whether there has been a fair distribution of the benefits of the restructuring (what some commentators have called the "restructuring surplus") between those classes who have agreed the Plan and those who have not.

Two additional interesting points arise from the judgment:

1. where the benefit provided to the dissenting class is externally sourced (as opposed to arising from the applicant's estate), any differential treatment between similarly placed creditors will be of much less significance, as it is difficult to identify any legal basis on which the dissenting class could complain about the choice made by the external contributory to apportion the contribution they made to the Plan in such manner as they saw fit; and
2. the Court may be prepared to have regard to the differential treatment of similarly

> placed creditors that are excluded from the Plan altogether, particularly if it appears that there are no good commercial reasons for taking that course, in assessing whether or not the Plan itself is "just and equitable".

In this case, a horizontal comparison was of much less significance than might otherwise be the case due to one class being secured, the DSC Other Plan Creditors being unsecured and out of the money in the relevant alternative, the distribution they received in the Plan being sourced from outside the Plan Companies, and there being no assets from which the DSC Other Plan Creditors would derive benefit in the absence of the Plan.

No Blot on the Scheme

As with Schemes, the Court will consider whether there is anything in the formulation of the Plan which causes concern as to how it will operate in practice as a mechanism for varying creditor rights and effecting a distribution of the available assets. In this case, there was no suggestion that there was a "blot" on the Plan.

Substantial Effect

Finally, the Court will also need to be satisfied that the Plan will be substantially effective in the relevant jurisdictions outside England and Wales, which is the same question that arises on any application to sanction a Scheme. However, by the time of the sanction hearing in DeepOcean, there was no need for the DeepOcean Plan to be recognised in any other jurisdiction and so this issue was not determined

Conclusion

This case provides some useful guidance on the factors that the Court will take into account when considering whether to exercise its discretion to sanction a Cram Down Plan. Ultimately, no creditors in this case appeared before the Court to argue against the DeepOcean Plan, and so Trower J was able to relatively easily conclude that it was a Cram Down Plan that ought to be sanctioned.

The question of turnout and representation of similarly placed classes in ascertaining whether a Plan is "just and equitable" may be confined to the unique features of this case. However, there is clearly fertile ground for development of the law relating to Cram Down Plans in future cases where a dissenting class is "in the money" in the relevant alternative and is aggrieved with their treatment under the Plan vis-à-vis the assenting classes. No doubt the court will be asked to grapple with much more difficult and complex fact patterns in the future.

Nevertheless, as with cram down under the US Chapter 11 regime, it is expected that the utility of Cram Down Plans in the UK restructuring framework will be their existence as a "stick" during restructuring negotiations to encourage stakeholders to coalesce around a consensual outcome.

If you would like more information about the topics raised in this briefing, please speak to your regular contact at Weil or to any of the authors listed below.

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