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Case No: CR-2021-000548, 549 and 550

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
INSOLVENCY AND COMPANIES LIST (ChD)

Royal Courts of Justice
Rolls Building
Fetter Lane
London, EC4A 1NL

Date: 12 May 2021

Before :
MR JUSTICE SNOWDEN

- -

IN THE MATTERS OF

VIRGIN ACTIVE HOLDINGS LIMITED
VIRGIN ACTIVE LIMITED
VIRGIN ACTIVE HEALTH CLUBS LIMITED

AND IN THE MATTER OF PART 26A OF THE COMPANIES ACT 2006

- -

Tom Smith QC, Ryan Perkins and Lottie Pyper
(instructed by **Allen & Overy LLP**) for the **Applicant Companies**
Robin Dicker QC and Georgina Peters
(instructed by **Sullivan & Cromwell LLP**) for an **Ad Hoc Group of Landlords**
David Allison QC (instructed by **Hogan Lovells LLP**) for the **Lender Group**

Hearing dates: 29–30 April, 3–5 May 2021

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APPROVED JUDGMENT

COVID-19: This judgment was handed down remotely by circulation to the parties' representatives by email. It will also be released for publication on BAILII and other websites. The date and time for hand-down is deemed to be 10.30 a.m. on Wednesday 12 May 2020.

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MR JUSTICE SNOWDEN

MR JUSTICE SNOWDEN :

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Introduction

1. This is an application on behalf of Virgin Active Holdings Limited (“VAHL”), Virgin Active Limited (“VAL”) and Virgin Active Health Clubs Limited (“VAHCL”) (together the “Plan Companies”). The Plan Companies seek an order sanctioning the restructuring plans (the “Plans”) proposed by each of the Plan Companies with certain of their creditors (the “Plan Creditors”) in accordance with section 901F of the Companies Act 2006 (the “CA 2006”).

2. I have previously handed down two judgments in connection with the Plans. On 1 April 2021, I handed down a judgment explaining my decision to convene class meetings of creditors for each of the Plan Companies (the “Convening Judgment”): see [2021] EWHC 814 (Ch). On 16 April 2021, I handed down a judgment in connection with the ability of certain creditors to recover their costs, a question which I reserved until after the conclusion of the sanction hearing: see [2021] EWHC 911 (Ch).

A. The Parties

The Plan Companies

3. The Plan Companies are part of the Virgin Active group (the “VA Group”), an international health club operator. A key holding company of the VA Group is Virgin Active Health Club Holdings Ltd (“VAHCHL”). VAHCHL’s ultimate shareholders are Brait Mauritius Limited (72.10%) and Sir Richard Branson (17.85%) (the “Shareholders”). The remaining 10.05% of the shares are held by the VA Group’s management and an employee benefit trust. VAHCHL remains fully solvent and was recently valued at between £350 - £400 million on an adjusted enterprise value valuation. It also owns a South African business, which is not part of the planned restructuring as it has separate financing arrangements and is not in financial distress.

4. The Plan Companies are all incorporated in England and are key entities in the VA Group's Europe & Asia Pacific business sub-group (the "Group"). Virgin Active Investment Holdings Limited ("VAIHL") is the ultimate parent company of the Group. VAHL is a wholly-owned subsidiary of VAIHL and VAL and VAHCL are wholly-owned subsidiaries of VAHL. There are currently a total of 102 clubs in the Group's business located in the UK, Italy, Australia, Thailand and Singapore, of which 39 are operated in the UK.

The Plan Creditors

5. The Group owes significant debts to certain "Secured Creditors" under a "Senior Facilities Agreement" which was entered into on 28 June 2017, with VAHL as the borrower and VAL and VAHCL (among others) as guarantors. There are currently eight facilities under the Senior Facilities Agreement providing financing of over £200 million, all bar one of which are fully drawn. The Senior Facilities Agreement is secured by various guarantees and security over property provided by, among others, the Plan Companies (the "Charged Property"). The Plan Companies have entered into an intercreditor agreement (the "Intercreditor Agreement") which regulates the enforcement of security over the Charged Property and the ranking and priority of certain claims. Both the Senior Facilities Agreement and the Intercreditor Agreement are governed by English law.

6. A sub-set of the Secured Creditors (the "Lender Group"), holding approximately £164 million of the total claims under the Senior Facilities Agreement, appeared by counsel (Mr David Allison QC) at the hearing to support the sanction of the Plans.

7. The second significant group of creditors of the Group for present purposes are the landlords under the leases of club premises in the UK (the "Landlords" and the "Leases"). There are 46 Landlords, who have granted a total of 67 Leases included within the Plans relating to 45 properties. Of these, 30 Leases have been entered into by VAL, 32 by VAHCL and five are joint leases. Some of the Leases are guaranteed by VAHL, some benefit from guarantees provided by other Group companies, and one is guaranteed by a company outside the Group. The arrears of unpaid rent owed to the Landlords in respect of the Leases will amount to about £30 million by the end of May 2021. Such amounts are all unsecured.

8. The Plans do not apply to leases of club premises in other jurisdictions. Those clubs are fewer in number, are not predicted to have such large cashflow requirements and the Group has generally been able to reach consensual agreements with the landlords. For example, approximately 90% of rent payments relating to the first lockdown period in Italy were waived, together with further rent reductions post-lockdown; in Thailand and Singapore, all landlords agreed that no rent would be charged for the periods in which clubs were closed; and in Australia, all landlords agreed partial rent waivers in respect of closure periods.

9. A sub-set of the Landlords (the "Ad Hoc Group" or "AHG Landlords") appeared by counsel (Mr. Robin Dicker QC) at the hearing to oppose the sanction of the Plans. The AHG Landlords are Aberdeen Standard Investments, The British Land Company plc, KFIM Long Income Property Unit Trust, Land Securities Properties Ltd, and the underlying property owners of the property that are managed by them. The AHG Landlords have been placed in, variously, Classes A to E of the Landlord creditors

under the Plans, the significance of which is explained below. In addition to appearing by counsel at the hearing, the AHG Landlords jointly instructed Sullivan & Cromwell LLP ("Sullivan & Cromwell") and PricewaterhouseCoopers LLP ("PwC") to advise them.

10. The third significant group of creditors of the Group for present purposes are approximately one hundred creditors who are not current Landlords in respect of Leases, but whose claims relate in various ways to properties which are or have in the past been occupied by the Group (the "General Property Creditors"). The debts owed to the General Property Creditors are all unsecured.

11. Many of the claims of General Property Creditors are contingent liabilities which relate to either authorized guarantees ("AGAs") or guarantees of authorized guarantees ("GAGAs") or covenants under privy of contract provided to landlords of properties that were assigned to third parties by the Plan Companies between 2014 and 2019. Such claims would arise if the assignee tenant were to default. The definition of General Property Creditors also includes creditors with a variety of other types of claims, which it is not necessary to set out here.

12. The General Property Creditors were not represented at the hearing and no member of the group made submissions in connection with the sanctioning of the Plans.

Excluded creditors

13. There are nine categories of liability which will not be compromised by the Plans. These include tax and employee-related liabilities of any nature, business rate liabilities and liabilities owed to trade creditors. The services of the employees are considered essential to the day-to-day business of the Group, as are the goods and services provided by large trade creditors such as utilities and providers of gym equipment. Moreover, given the large number of smaller trade creditors, the cost and complexity of including such creditors in the restructuring was thought to be disproportionate and not feasible in the limited time available.

B. <u>Background to the Restructuring</u>

The Group's financial difficulties

14. Prior to the COVID-19 pandemic, the Group was in a strong and sustainable financial position. The Group's business model is based on subscriptions, with members of its clubs making monthly payments of membership fees. Additional revenue is generated by ancillary services, including personal training and other forms of individual and group instruction. This drives substantially the whole revenue of the Group. As such, its financial position has been severely affected by the COVID-19 pandemic. Government-imposed shutdowns around the globe have forced gyms to close in all of the Group's territories. Membership payments have been suspended during such closures and many members have opted to cancel or suspend their memberships for longer periods.

15. The result of the closures has been dramatic. The Group suffered a drop of income of £185.4 million year-on-year in 2020, and £53 million year-on-year for the first two months of 2021. The underlying EBITDA of the Group fell from positive £56.8 million

in the year ending 31 December 2019 to negative £42.1 million in the year ending 31 December 2020 (a fall of 173.7%). The clubs in the UK have been closed throughout 2021 and, by the end of February 2021, had been partially or fully closed for nine of the last twelve months. In the same period, its clubs in Italy had been partially or fully closed for eight of the last twelve months. The result for the first two months of 2021 was a fall in underlying EBITDA from positive £6.9 million for the same two months in 2020 to negative £20.3 million (a fall of 392%).

16. This dramatic drop in revenue caused by the pandemic has put increasing pressure on the Group's cash flow position. At the same time, the Group has remained (and remains) subject to many of the fixed costs and overheads inherent in its business model, including its obligations to the Landlords under the Leases and its obligations to the Secured Creditors under the Senior Facilities Agreement.

Developments in 2020

17. On 23 March 2020, the Prime Minister announced the first lockdown in the UK in response to the emerging COVID-19 pandemic, issuing the first of what would become a series of "stay at home" orders. On 26 March 2020, lockdown measures legally came into force.

18. Faced with a prolonged and uncertain closure period and the loss or suspension of its primary source of revenue, the Group took a number of steps to preserve cash, including by accessing governmental support in various jurisdictions, deferring the payment of tax liabilities, obtaining rent deferrals (where available), furloughing more than 95% of its UK staff, and significantly reducing its spending. The aggregate support and savings amounted to some £87 million for the Group in 2020 but further action was required.

19. From May 2020, the Group began to engage with the Landlords to seek agreement with them to alleviate the financial difficulties facing the Group. The negotiations resulted in limited success, restricted largely to short- to medium-term rent deferrals (as distinct from waivers). By 5 November 2020, only one Landlord in the UK had waived rent for any part of the closure period, save in respect of rent concessions agreed as part of lease extensions. The position in the UK can be contrasted with that in other jurisdictions, where the Group achieved a greater level of success in its negotiations with landlords. Thus, in the UK, the rent waivers granted by the Landlords were approximately £1.39 million, representing 5% of total annual rent or the equivalent of 0.6 months rent-free as against an average closure period of 5.4 months; in Italy, rent waivers were approximately £9.66 million, representing 37% of total annual rent or the equivalent of 4.4 months rent-free as against an average closure period of 4.5 months; in APAC, rent waivers were approximately £6.1 million, representing 29% of total annual rent or the equivalent of 3.4 months rent-free as against an average closure period of 3 months.

20. The Group's rent arrears in the UK have accrued in circumstances where Landlords are prohibited by law from taking enforcement action ordinarily available to them. Section 82 of the Coronavirus Act 2020 provides that a landlord's right of re-entry or forfeiture under a relevant business tenancy for non-payment of rent may not be enforced, by action or otherwise, during the relevant period, which began on 1 March 2020 and is currently due to end on 30 June 2021. Schedule 10 to the Corporate Insolvency and Governance Act 2020 also severely restricts the ability of landlords to present a winding-up petition against a tenant for non-payment of rent during the same period.

21. In June 2020, the Group sought support from the Secured Creditors and the Shareholders. Support was provided to the Group by the Secured Creditors by way of an additional £25 million term loan facility under the Senior Facilities Agreement (the "Additional Facility"). At the same time, the Group obtained certain amendments and waivers under the Senior Facilities Agreement, the effect of which was to limit the circumstances in which events of default would be triggered under the agreement.

22. Also in June 2020, the Group obtained a new cash injection from the Shareholders by way of an unsecured loan of £20 million (the "Shareholder Loan"). The Shareholder Loan is subordinated to the Group's obligations under the Senior Facilities Agreement and ranks *pari passu* with the Group's other unsecured liabilities. The Shareholder Loan will be compromised as part of the Plans.

23. Further support was obtained from Virgin Enterprises Limited ("VEL"), the licensor of the Virgin brand, which is ultimately owned by Sir Richard Branson, in the form of the deferral of £5 million of royalties under licensing arrangements in respect of the Virgin Active brand.

24. The steps described above did not stabilise the Group's financial position nor eliminate the liquidity risks it faced. However, in the summer of 2020, the UK's national lockdown began to ease. On 10 May 2020, the UK Government announced a conditional plan for lifting lockdown. On 1 June 2020, the phased re-opening of schools in England began. On 15 June 2020, non-essential shops in England reopened and, most importantly for present purposes, on 25 July 2020, indoor gyms, swimming pools and sports facilities were permitted to reopen.

25. It was against this somewhat more optimistic backdrop that, in October 2020, the Group instructed Deloitte LLP ("Deloitte") to advise the Group on possible restructuring options. The terms of the engagement were set out in an engagement letter dated 8 October 2020, which was on its face addressed to VAHCHL, the key holding company of the Group (and not one of the Plan Companies). Deloitte were specifically asked to focus on three possible restructuring options, namely: (i) a company voluntary arrangement ("CVA"); (ii) administration; and (iii) consensual landlord negotiations.

26. On 22 October 2020, Deloitte gave a presentation to the Board of VAHCHL, the key conclusion of which was that there was not (at that stage) any impending breach of the minimum liquidity covenants in the Senior Facilities Agreement, nor was there an anticipated cash shortfall following the support secured from the Secured Creditors (in the form of the Additional Facility), the Shareholders (in the form of the Shareholder Loan), and VEL (in the form of the licence deferral). Deloitte advised the Group that although no broader financial restructuring involving a sale of the business or any formal restructuring or insolvency process was necessary or appropriate at that stage, it would be prudent to keep the situation under review.

27. The optimism that swept the country as the COVID-19 pandemic appeared to be receding in summer 2020 began to give way in the face of rising case numbers, hospitalisations, and deaths. On 31 October 2020, the UK government announced a second national lockdown in the UK to commence on 5 November 2020. The second national lockdown ended on 2 December 2020 and was replaced by a three-tier system of restrictions. In parallel, the Italian government announced a national lockdown on 4 November 2020. The picture in the UK continued to worsen, culminating in the

announcement on 19 December 2020 that there would be minimal relaxation of restrictions over the Christmas period (and no relaxation at all in certain areas).

28. In late November and early December 2020, the Group therefore re-engaged Deloitte and commenced further work on the restructuring options available to them. The scope of work undertaken by Deloitte was reflected in an addendum to their engagement letter dated 17 December 2020 (again addressed on its face to VAHCHL) and was, in summary, to analyse the available options to address the Group's ongoing financial difficulties, including to assess the concessions that might be sought from the Group's various stakeholders.

29. Deloitte produced a report dated 24 December 2020 (the "Christmas Eve Report"), which concluded that if clubs in the UK and Italy remained closed until March 2021, the consequences were likely to include a breach of the minimum liquidity covenant under the Senior Facilities Agreement and a cash shortfall by the middle of March 2021. The Christmas Eve Report set out three options, and recommended that the Group seek an urgent solution by March 2021 to obtain support from various stakeholders whilst at the same time continuing to pursue the sale of the Italian business (discussions in respect of which had been ongoing since October 2020). The Christmas Eve Report was presented (by the Group and Deloitte) to representatives of the Shareholders on 30 December 2020.

30. The recommendations made in the Christmas Eve Report were rapidly overtaken by events. On 4 January 2021, the UK government announced a third national lockdown which made it highly likely that all of the Group's UK clubs would be closed for the foreseeable future. On or around 13 January 2021, the Group – in discussions with its legal and financial advisers – concluded that it was necessary to develop a restructuring plan. Deloitte entered into a further addendum to their engagement letter, dated 15 January 2021, by which it agreed to provide ongoing support in developing and implementing a restructuring plan whilst in parallel working on contingency options should the plan fail.

Negotiating the terms of the Restructuring

31. From 13 January 2021, two directors of the Plan Companies – Mr. Bucknall (the CEO) and Ms Hartley (the CFO) – and Deloitte began meeting with representatives of the Group's Shareholders to discuss what funding the Shareholders would offer as part of any restructuring. The rationale for approaching the Shareholders first was that they were major existing stakeholders with the greatest incentive to invest on favourable terms. The intention was to formulate a proposal from the Shareholders which could be put to the Secured Creditors, the support of which would also be critical to any successful restructuring. In parallel with those discussions, the Group and Deloitte held discussions with VEL seeking further concessions to licensing arrangements to ease the Group's liquidity crisis.

32. Discussions between the Group and the Shareholders in January 2021 ultimately resulted in a proposal for a package of support and compromises to be provided by the Shareholders and the intermediate companies in the VA Group as part of a wider restructuring.

33. In order to facilitate the provision of additional funding by the Shareholders, it was necessary for the Group to obtain waivers and consents from the Secured Creditors under the Senior Facilities Agreement. The Group first approached the Secured Creditors on or around 11 January 2021 through a series of bilateral calls to explain to each of them the liquidity crisis facing the Group, and to request that the Secured Creditors appoint joint legal and financial advisers to represent their shared interests. The Group, together with Deloitte, had a meeting with the Secured Creditors and their joint advisers on 25 January 2021, at which the Group gave a presentation outlining the scale of the problems it faced and to foreshadow the Restructuring proposal.

34. On 1 February 2021, a proposal was presented to the Secured Creditors jointly by the Group and the Shareholders. A central part of that proposal was that the Shareholders would commit new funding on a super senior basis (i.e., ranking ahead of the Secured Creditors' lending under the Senior Facilities Agreement). It became clear following the presentation that the Secured Creditors would not consent to any further lending on that basis.

35. The Group, the Shareholders and the Secured Creditors continued to seek a mutually acceptable solution throughout February 2021. One option proposed by the Secured Creditors as part of those discussions was the possibility of them providing short-term support (in the form of a waiver of the minimum liquidity covenant and the injection by them of additional funding on a super senior basis) with a view to a restructuring being launched in May 2021, as part of which the Secured Creditors would take an equity stake in the business. That proposal was rejected by the Group.

36. On or around 17 February 2021, the Shareholders revised their proposal as to the basis upon which they would commit new funding to the Group. The main sticking point, concerning the ranking of any new debt to be provided by the Shareholders, was ultimately resolved when the Shareholders (through their affiliates) agreed to lend up to £25 million of new funding to rank junior to the Secured Creditors' lending under the Senior Facilities Agreement.

37. On 10 March 2021, the Lender Group (i.e. the Secured Creditors holding in aggregate 80.24% of the commitments under the Senior Facilities Agreement), VEL, the Shareholders, the Plan Companies and certain other members of the Group (including VAHCHL) entered into a "Support Agreement", the purpose and effect of which was to commit its signatories to supporting the Plans by voting in favour of them and (where relevant) negotiating the documentation necessary to implement a wider restructuring (the "Restructuring"). On the same date, a letter was issued to Plan Creditors under the Practice Statement relating to Part 26 and Part 26A of the CA 2006 [2020] BCC 691 (the "PSL").

38. Under the Restructuring, the package to be provided by the Shareholders and their affiliates will include:

    i) the capitalisation of approximately £185 million of inter-company liabilities owed to direct or indirect shareholder companies. This includes the capitalisation of the Shareholder Loan of £20 million advanced in June 2020;

    ii) the waiver of approximately £9.4 million and the deferral of approximately £15.4 million of liabilities under the licensing arrangements with VEL;

iii) the provision of a secured loan of £25 million from VAHCHL which itself borrowed such sum from affiliates of the Shareholders (Brait Capital International Limited and Virgin Holdings Limited) to enable the Plans to be proposed (the "Pre-Implementation Facility");

iv) the provision of a further loan of £20 million from the affiliates of the Shareholders to provide additional liquidity for the Group after the Plans take effect (the "Post-Implementation Facility");

v) an obligation to contribute up to £6 million of equity into the Plan Companies to enable payments to be made to Landlords and General Property Creditors under the Plans. (It was unclear from the evidence how the £6 million equity injection was formulated but it does not appear to have formed part of the negotiations between the Group, the Secured Creditors and the Shareholders in February 2021); and

vi) the waiver of certain events of default.

39. Two commercially critical parts of the package described above are the Pre-Implementation Facility and the Post-Implementation Facility. The Pre-Implementation Facility was made available to the Plan Companies on 10 March 2021 to provide the Group with sufficient liquidity to promulgate the Restructuring and the Plans. It currently ranks *pari passu* with the Senior Facilities Agreement but, following the completion of the Restructuring, it will be subordinated to the Senior Facilities Agreement. The Post-Implementation Facility is a term loan facility to be borrowed by VAHL, the main consequence of which will be to provide an additional £20 million of liquidity to the Group. That facility will also rank junior to the Senior Facilities Agreement. It is the Plan Companies' evidence that the terms on which the Shareholders have agreed to advance those new monies are better than the terms which would be available from a third party in the market. This is an issue to which I shall return below.

Discussions with Landlords

40. It is apparent from the foregoing that the Landlords were not parties to the negotiations which led to the formulation and development of the Restructuring generally nor the terms of the Plans specifically. The evidence of the Plan Companies was that the Group engaged in discussions with the Landlords about the Restructuring from the beginning of February 2021. Mr Bucknall characterised the discussions with 39 of the Plan Companies' 46 Landlords as "*positive engagement*", including by attending virtual meetings or calls, exchanging emails and providing information.

41. In February 2021, the AHG Landlords jointly instructed PwC and Sullivan & Cromwell to advise them and represent their interests. The characterisation of the discussions between the Plan Companies and the Landlords as positive was disputed by the AHG Landlords, who described limited success in engaging meaningfully with the Group throughout this period. They claim to have been rebuffed in their efforts to obtain further information and documents from the Group in connection with the Restructuring, and complain that the Group declined to pay the fees incurred by the AHG Landlords in considering the Restructuring proposals. Following the circulation

of the PSL on 10 March 2021, the AHG Landlords described further efforts to engage with the Group, which they said were similarly unsuccessful.

Discussions with General Property Creditors

42. Given the time and resources involved in engaging with the General Property Creditors, the Group did not engage with the more than one hundred persons or entities falling into that category prior to the distribution of the PSL. Accordingly, the first time General Property Creditors as a group were notified of the Restructuring was upon receipt of the PSL on 10 March 2021. There has been a relatively low level of engagement with General Property Creditors since that date.

Discussions with other potential investors and purchasers

43. It is common ground that the Plan Companies did not undertake a full "market testing" process as part of the development of the Restructuring proposals. The main consequence of this was that the value of the Group's businesses was determined on a "desktop" basis. I return to this issue below in considering the main criticisms made by the AHG Landlords of the process by which the Plans were formulated and the weight that I should place on the Plan Companies' evidence. For present purposes, I simply record, as part of the chronological background, three instances of discussions which did take place with third parties.

44. In October 2020, the Group was approached by a potential purchaser of the Italian business. Between November 2020 and February 2021, the Group entered into discussions with the potential purchaser and extensive financial and legal due diligence was conducted over the period, although detailed commercial terms were never agreed. As a result of the lack of meaningful progress, the directors of the Plan Companies ultimately decided to pause the negotiations in early February 2021, and no further discussions have since been held with the prospective purchaser.

45. Second, in late January 2021, Mr Bucknall approached what he described as a leading private equity firm with extensive knowledge and experience in the sector. After some discussions during that month, the private equity firm notified Mr Bucknall that it did not wish to pursue any investment in the business.

46. Third, between January and March 2021, a private equity fund (Ethos) contracted by the Group's majority Shareholder (Brait) was contacted by a number of investment funds about the possibility of investing in the Plan Companies. The evidence of Mr. Bucknall (who was not involved) was that he understood that of eight funds which approached Ethos as potential investors, three funds made proposals that involved lending funds to the Plan Companies on a super senior basis. The provision of funds on a super senior basis would have required the unanimous consent of the Senior Creditors, which Mr Bucknall suggested (and I accept) was unlikely ever to be obtained.

The current financial position of the Group

47. The most recent evidence of the financial position of the Group was given by Ms Hartley. In summary, whilst there have been some improvements in the cash position of the Group since the Convening Hearing (largely the result of outperforming expectations in relation to membership recovery), the liquidity crisis facing the Group

is essentially unchanged. Ms Hartley's evidence was that if the Plans are not implemented this week (commencing 10 May 2021), the Group is forecast to run out of cash, be forced to use its overdraft and fall below the minimum liquidity required to run the business at the start of next week.

48. The evidence of the directors of the Plan Companies was that the Restructuring (including the Plans) is the only viable option to rescue the Plan Companies. The evidence of the directors is accordingly that if the Plans are not approved and implemented, they would have no choice but to put the Plan Companies into administration.

C. Summary of the relevant alternative

49. In early February 2021, Deloitte was asked to prepare a report setting out its views on the likely outcomes for Plan Creditors in the event that the Plans were not approved. Deloitte's advice was contained in a report dated 19 March 2021 (the "Relevant Alternative Report").

50. Deloitte modelled two scenarios for the administration of the Group. The first (Scenario 1) involves a trading administration of the Group's business in the UK for about six weeks to achieve an orderly sale of all or parts of the Group's UK business and assets, in conjunction with a sale by the VA Group of the solvent companies which operate in Italy, the Asia Pacific region and South Africa. The second (Scenario 2) is a liquidation of the Group's assets.

51. Deloitte advised that Scenario 1 will achieve a better return for Plan Creditors than Scenario 2, and that it is therefore also the more likely alternative, because the Secured Creditors will have a considerable incentive to finance a trading administration to improve their recoveries. In Scenario 1, Secured Creditors are estimated to achieve a return in the region of 84.6 p/£, whereas in Scenario 2, Secured Creditors are estimated to achieve a return of just 21.8 p/£. The net funding requirement to enable administrators to pursue Scenario 1 is estimated by Deloitte to be in the region of £15.9 million.

52. However, and most importantly for present purposes, even on the basis of the more optimistic scenario, Deloitte calculated that the Secured Lenders would not receive full payment of their debts and that there would likely be a shortfall of £39 million for the Secured Creditors. This figure has been calculated by aggregating the estimated sale proceeds for each of the UK, Italy and APAC businesses (which it is assumed would be sold separately), together with other realisations, and deducting from that sum the total liabilities owed by the Plan Companies, the largest part of which (by far) is the debt owed to the Secured Creditors.

53. Deloitte also calculated the estimated returns under Scenario 1 for the different groups of Plan Creditors. As I have noted above, for the Secured Creditors, this would amount to 84.6 p/£. For the Landlords and the General Property Creditors, who are unsecured, the estimated return would be very poor indeed. The exact number depends upon which Plan Company is the debtor and whether the Plan Creditor also has a claim under a guarantee against one or more of the other Plan Companies or against a solvent company inside or outside the Group. But putting aside the very limited number who have guarantee claims against a solvent company, for the most part the estimated

administration return to Landlords and General Property Creditors from the Plan Companies would be minimal, being only the statutory "prescribed part" under section 176A of the Insolvency Act 1986 of up to £600,000 in respect of each Plan Company.

54. The estimated administration return calculated by Deloitte for Landlords and General Property Creditors (the "Estimated Administration Return") forms the basis for a central feature of the Plans, namely the "Restructuring Plan Return". This is simply a sum calculated at 120% of the Estimated Administration Return. The origins of the 20% uplift were not explained in the evidence, but it seems clear that it was designed by the Plan Companies or their advisers to provide the relevant Plan Creditors who are to receive it with a greater return they could expect to receive in respect of their claims in the "relevant alternative" scenario to the implementation of the Plans. The Plan Companies plainly intend that this will engage the power of the Court under Section 901G in Part 26A of the CA 2006 to sanction the Plans and "cram down" any dissenting classes of the Landlords and the General Property Creditors.

55. Questioning the reliance that can be placed by the Court upon the Relevant Alternative Report formed a key part of the AHG Landlords' case in opposition to the sanctioning of the Plans. I address below the main criticisms made on behalf of the AHG Landlords in this regard. For present purposes, I simply note that the information used by Deloitte to prepare the Relevant Alternative Report included the analysis set out in a valuation report prepared by Grant Thornton on 18 March 2021 (the "GT Report"), with a valuation date of 18 February 2021, which was in turn based upon information provided to Grant Thornton by management.

D. <u>The Plans in outline</u>

56. In broad outline, the treatment of the different groups of Plan Creditors under the Plans is as follows.

The Secured Creditors

57. The Secured Creditors under the Senior Facilities Agreement will not suffer any reduction in the amount owing to them under the Plans.

58. The concessions given by the Senior Creditor Group as part of the Plans are various, but the six most important are as follows;

   i) the maturity of the Senior Facilities Agreement is to be extended under the terms of the Plans from 30 June 2022 to 30 June 2025, representing an additional period of credit risk during which there are no scheduled principal debt repayments;

   ii) there will be significant amendments to the interest provisions of the Senior Facilities Agreement. The changes will result in the Secured Creditors having around £9.2 million of interest payments deferred and capitalised over the next 18 months;

   iii) there will be significant amendments to the provisions which permit the Plan Companies to borrow additional sums of up to £50 million without any requirement to obtain further consents or waivers under the Senior Facilities

Agreement; such further borrowing will rank *pari passu* with the claims of Secured Creditors and will share in the Charged Property;

iv) the mandatory requirement under the Senior Facilities Agreement to apply net disposal proceeds in prepayment of the debt under the Senior Facilities Agreement will be amended to permit the Plan Companies to undertake a series of planned sales of clubs, and to retain up to £25 million of the net proceeds;

v) there will be a significant relaxation of the financial covenants in the Senior Facilities Agreement; and

vi) there will be a relaxation of the events of default in the Senior Facilities Agreement.

The Landlords

59. Although the Landlords would all rank *pari passu* in respect of their claims in the separate administrations of the respective Plan Companies, the Leases have been divided into five classes (A-E) for the purpose of their treatment under the Plans. In essence, Classes A and B are the Leases which are most profitable and which the Group wishes to retain. The clubs operated at the premises covered by the Class A Leases are regarded as the most profitable and critical to the Group's survival, or as being most attractive to a potential buyer. Class B Leases represent profitable sites but which are less critical to the Group. The claims of the Landlords in respect of these Leases are treated most favourably under the Plans.

60. By contrast, Classes D and E Leases are sites which are loss-making which the Group does not wish to retain. All present and future claims of the Landlords in respect of these Classes are effectively eliminated in return for payment of the basic Restructuring Plan Return.

61. Class C Leases fall into something of a middle ground from the perspective of the Plan Companies. They are sites which were minimally profitable prior to the pandemic and which are forecast to be loss-making during any administration period.

62. The allocation of Leases to Classes A-E has been done in two stages. First, the Plan Companies conducted an analysis of each leased site's operating profit for the financial year ending 31 December 2019 (after an allocation for head office costs), rounded to the nearest whole number. The Class A Leases were those sites that achieved an operating margin derived from the operating profit of at least 25 per cent; Class B Lease sites achieved an operating margin derived from the operating profit of between 10 and 25 per cent; Class C Lease sites achieved an operating margin derived from the operating profit of between 0 and 10 per cent; Class D Lease sites were operating at a loss; and Class E Lease sites comprised Leases with Subsidised Sub-tenants which the Plan Companies consider could not be made financially viable if they were to remain in occupation.

63. Secondly, the Plan Companies considered whether any particular circumstances justified reclassification of any Lease. The evidence explained that this included situations where the operating profit margin was close to the cut-off point for any class. Five adjustments were made at the second stage, including, for example, where it could

be foreseen that a particular club would soon become as profitable as those in a higher category, or where the Plan Companies were advised that the premises in question were under-rented. In such a case it could be assumed that in an administration a purchaser of the Lease would agree to pay off any arrears in full, such that the Landlord concerned would not achieve a better return if placed in a lower Class under the Plans and its claims for arrears or rent were eliminated.

64. Under the Plans, all of the Landlords will retain the right to take steps to determine their Lease, whether by forfeiture or otherwise. This reflects the position in relation to a company voluntary arrangement in which it has been held that a landlord cannot be prevented from exercising an accrued right to forfeit the lease on the ground of the tenant's insolvency: see Discovery (Northampton) Ltd v Debenhams Retail Ltd [2020] BCC 9. Similarly, it has been held that a scheme of arrangement cannot force a landlord to accept a surrender of a lease: see Re Instant Cash Loans Ltd [2019] EWHC 2795 (Ch). The Plans therefore do not provide for the Landlords to suffer any involuntary termination or surrender of any Leases (or indeed any sub-leases).

65. If, however, a Landlord successfully forfeits or terminates a Lease before the Voting Record Date for the Plans, then the Plans provide that such Landlord will become a General Property Creditor in respect of the liabilities arising. If such action is taken after the Voting Record Date but within 33 months from the Restructuring Effective Date, then the relevant Landlord will be entitled to be paid the Restructuring Plan Return in respect of any court order obtained as a result.

66. Subject to those provisions in respect of determination of any Lease, in broad outline, the treatment of the Landlords in respect of the different Classes of Lease under the Plans is as follows.

i) Class A Landlords:

a) All rent arrears will be paid within three business days of the Restructuring Effective Date.

b) During a "Rent Concession Period" of up to three years, fixed rent due under the Lease (the "Contractual Rent") will be paid monthly in advance.

c) At the end of the Rent Concession Period, payments will revert so that they are made in accordance with the terms of the relevant Lease.

ii) Class B Landlords:

a) All outstanding rent arrears will be released and discharged, in return for a payment of the Restructuring Plan Return.

b) During the Rent Concession Period, Contractual Rent will be paid monthly in advance.

c) At the end of the Rent Concession Period, payments will revert so that they are made in accordance with the terms of the relevant Lease.

iii) Class C Landlords:

a) All outstanding rent arrears will be released and discharged.

b) During the Rent Concession Period (which for Class C Landlords may end sooner than three years if the club in question returns to 2019 levels of profitability), Contractual Rent will be cut by 50%.

c) There will be a deferral of payments of such reduced Contractual Rent until 1 January 2022 and such rent will then be paid in 60 equal monthly instalments commencing on 1 January 2022.

d) The reduced Contractual Rent for the period from 1 January 2022 to the end of the Rent Concession Period shall be paid at monthly intervals in advance.

e) No rent shall be payable for any period during the three year period after the Restructuring Effective Date in which the relevant premises are required to be closed for any continuous period of at least 28 days as a result of any government regulation imposed in relation to COVID-19.

f) At the end of the Rent Concession Period, payments will revert so that they are made in accordance with the relevant Lease.

g) Each Class C Landlord will be entitled to terminate their Lease on 30 days' notice, provided that the Notice to Vacate is delivered within 90 days of the Restructuring Effective Date. If a Class C Landlord exercises this break right, the relevant Plan Company will pay 30 days’ worth of its Contractual Rent and rent relating to turnover (if any). If and to the extent that this payment is insufficient to provide the relevant Class C Landlord with a Restructuring Plan Return, the relevant Class C Landlord will be entitled to receive a further payment to make up the shortfall.

iv) Class D Landlords:

a) From the Restructuring Effective Date, no past, present or future rent, service charge, insurance or other liabilities will be payable and the relevant Plan Company will no longer have any obligations towards them. In exchange, each Class D Landlord will be entitled to a Restructuring Plan Return.

b) Each Class D Landlord will have a rolling break right exercisable on 30 days' notice. If a Class D Landlord serves a Notice to Vacate within six months of the Restructuring Effective Date, the relevant Plan Company will pay 30 days’ worth of Contractual Rent and, to the extent that this payment is insufficient to provide the relevant Class D Landlord with a Restructuring Plan Return, they will be entitled to receive a further payment to make up the shortfall.

v) Class E Landlords:

a) From the Restructuring Effective Date, no past, present or future rent, service charge, insurance or other liabilities will be payable and the relevant Plan Company will no longer have any obligations under the Lease. In exchange, each Class E Landlord will be entitled to a Restructuring Plan Return.

b) The relevant Plan Company will pay to the relevant Class E Landlord any amounts for Contractual Rent, any amounts in respect of turnover-related rent and amounts in respect of service charge and insurance in respect of the Class E Premises received from any sub-tenant.

c) Each Class E Landlord will have a rolling break right exercisable immediately on or after the Restructuring Effective Date. This right can be exercised by serving a Notice to Vacate.

67. The Lease Guarantees given by the Plan Companies will be directly compromised and varied under the terms of the relevant Plan, in order to align the guarantee with the amended terms of the underlying Lease.

General Property Creditors

68. The Plans will compromise the claims of the General Property Creditors against the Plan Companies in return for payment of a Restructuring Plan Return.

Payment of Restructuring Plan Return

69. Where the Plans contemplate that a Plan Creditor will receive a Restructuring Plan Return, there are detailed provisions for submission of claims by a specified bar date between 9 and 33 months after the Restructuring Effective Date. If a relevant Plan Creditor fails to submit a Notice of Claim by the relevant bar date, they will be deemed to have waived and released their right to any Restructuring Plan Return.

70. Each Notice of Claim will be assessed by Deloitte (as "Plan Administrator") which may request further information or documentation from the relevant creditor prior to admitting the Notice of Claim in whole or in part and in the event of a dispute, providing the relevant creditor with reasons in writing as soon as reasonably practicable. A Plan Creditor whose claim is disputed may deliver a notice to the Plan Administrator within 21 days. There is then a dispute resolution mechanism involving submission of the dispute to binding determination by an independent accountant acting as expert.

71. It is intended that the Restructuring Plan Returns will be paid between one and three years after the Restructuring Effective Date. Most of these payments will be paid one year after the Restructuring Effective Date. The timetable is contended by the Plan Companies to be similar to the time that it would be likely to take before any dividend would be paid in an administration, which is anticipated to take between 18 months and two years to be paid out due to the complexity of the Group and the time it would take to complete all asset realisations.

Other provisions

72. As explained above, the Plans vary the rights of certain Landlords against certain guarantors within the VA Group. This falls within the scope of a compromise or

arrangement between the Plan Companies and the Landlords, since the guarantors would otherwise have a "ricochet" claim against the relevant Plan Companies which would defeat the purpose of the Plans: see Re Gategroup Guarantee Ltd [2021] EWHC 304 (Ch) at [163], where the authorities are considered.

73. Finally, the Plans provide for a release of the professional advisers to the Plan Companies, the directors of the Plan Companies and various other persons involved in the Restructuring from any liability arising out of the negotiation and implementation of the Restructuring. Such a clause is not uncommon and can fall within the concept of a compromise or arrangement between a company and its creditors in their capacity as such: see Re Far East Capital Ltd SA [2017] EWHC 2878 (Ch) at [13]-[14] and Re Noble Group Ltd [2019] BCC 349 (sanction judgment) at [20]-[30].

E. The Convening Judgment

74. I handed down the Convening Judgment on 1 April 2021. I held that due to the relatively short notice period that had been given for the convening hearing, it was right (as the Plan Companies accepted) that any Plan Creditors who wished to raise issues of class composition or jurisdiction at the sanction hearing would not be restricted from doing so: [47] – [52] of the judgment. In the event, no party has raised those issues at the sanction hearing and the submissions I have heard have focused on the conditions in section 901G of the CA 2006 and the Court's discretion to sanction the Plans.

75. I held, further, that the threshold conditions under section 901A are clearly met in relation to each Plan Company: [53] – [59] of the judgment. The evidence is clear that each Plan Company has encountered financial difficulties as a result of the coronavirus pandemic that are affecting and will affect their ability to carry on business as going concerns: section 901A(2) (Condition A). Moreover, there is no doubt that the Plans clearly involve the requisite element of "give and take" to amount to a compromise or arrangement between the Plan Companies and the Plan Creditors, and there is also no doubt that the purpose of the Plans is to address the financial difficulties facing the Plan Companies: section 901A(3) (Condition B).

76. I accepted the suggested approach of the Plan Companies to divide Plan Creditors into seven basic classes: the Secured Creditors, the General Property Creditors, and the Landlord Creditors divided into Classes A to E, resulting in a total of 21 Plan Meetings across the three Plan Companies: [60] – [90] of the judgment. I also accepted, despite submissions on the issue from the AHG Landlords, that the Explanatory Statement appeared to be in an appropriate form and that certain additional information requested by the AHG Landlords did not need to be included in it: [114] – [124] of the judgment.

77. I did, however, indicate that certain materials should be disclosed by the Plan Companies to any requesting creditors (including the AHG Landlords) subject to appropriate confidentiality undertakings being given to the court by those persons who wished to access the confidential materials: [125] – [134] of the judgment. At the sanction hearing, Mr Dicker QC on behalf of the AHG Landlords made submissions as to the (in)adequacy of the information provided by the Plan Companies but did not advance this as an independent basis upon which I should decline to sanction the Plans. I return to this issue below.

78. Finally, I directed that it was appropriate for the Plan Meetings and the sanction hearing to take place within an urgent timeframe, given the acute liquidity crisis facing the Plan Companies: [142] – [150] of the judgment.

F. The Plan Meetings

79. Each of the Plan Meetings convened by my Order of 29 March 2021 was held by video conference on 16 April 2021, and the unchallenged evidence before me was that the meetings were summoned and held in accordance with the directions given. No person has sought to suggest that there was any impropriety or unfairness in the conduct of the Plan Meetings.

80. The outcomes by value for those voting at the Plan Meetings were as follows (the numbers have been rounded):

i) Secured Creditors: 100% in favour for each of VAHL, VAL and VAHCL.

ii) Class A Landlords: 100% in favour for each of VAHL and VAL; and 98.91% in favour for VAHCL.

iii) Class B Landlords: 42.64% in favour for VAHL; 44.73% in favour for VAL; and 19.23% in favour for VAHCL.

iv) Class C Landlords: 0% in favour for each of VAHL and VAL; and 66.60% in favour for VAHCL.

v) Class D Landlords: 0% in favour for each of VAHL, VAL and VAHCL.

vi) Class E Landlords: 0% in favour for each of VAHL and VAL; and 8.24% in favour for VAHCL.

vii) General Property Creditors: 0% in favour for VAHL; 6.89% in favour for VAL; and 0% in favour for VAHCL.

81. Thus, in each case, the relevant Plan for each Plan Company was approved by those voting at all the class meetings of the Secured Creditors and the Class A Landlords. Although the votes of the Class B Landlords were more evenly split, none of the other classes voted in favour of the Plans by the required statutory majority. There was one class of the Class C Landlords that voted in favour, but not by the required statutory majority. There were nine Plan Meetings of the Class C-E Landlords and the General Property Creditors which voted strongly against the Plans. In terms of overall value, the VAHL and VAL Plans were each approved by 77% of Plan Creditors voting at the meetings, and the VAHCL Plan was approved by approximately 72% of Plan Creditors voting at the meetings.

G. Overview of the witness evidence

82. I was presented with a large volume of evidence on behalf of the Plan Companies and the AHG Landlords at both convening and sanction. I provide here a brief overview of the key witnesses and the main topics in respect of which each of them gave evidence. In the following sections, I draw upon and assess the key parts of that evidence by reference to the issues in dispute between the parties.

83. As a preliminary observation I should say that each of the witnesses gave evidence and were cross-examined remotely on the Teams video platform. I am entirely satisfied that this was a reliable means to receive and test their evidence. I consider that the witnesses of fact gave their evidence carefully and truthfully and attempted to assist the court where they could. That was also true of the accountants and valuers who were defending or criticising the views expressed in the Relevant Alternative Report and the GT Report.

84. The Plan Companies relied on the following evidence:

i) four witness statements from Mr Bucknall, the CEO and a director of each Plan Company. Mr Bucknall co-founded the Group in 1999 and has extensive experience in the gym and leisure sector. He was also, together with Ms Hartley, the director of the Plan Companies most closely involved in the formulation and development of the Restructuring. Mr Bucknall's evidence addressed a range of topics, including the background to the Plan Companies; the impact of the COVID-19 pandemic on the finances of the Group, and the circumstances leading to the Restructuring; the steps taken by the directors of the Plan Companies to mitigate the financial impact of the pandemic; the key terms of the Restructuring and the Plans; the relevant alternative in the event the Plans were not sanctioned; and the extent of market-testing undertaken by the directors;

ii) two witness statements from Ms Hartley, the CFO and a director of each Plan Company since 2015. Ms Hartley is accountable for, among other things, the annual short- and long-term planning and forecasting for the Plan Companies, financial reporting, M&A activities and financing arrangements. Ms Hartley's evidence principally concerned the Group's business plan and explained some of the key information underlying the preparation of the GT Report and the Relevant Alternative Report;

iii) two statements from Mr Nicholson, a partner at Deloitte specialising in restructuring and an adviser to the Plan Companies. Mr Nicholson has been with Deloitte since 2003 and his work consists almost exclusively of advising financially distressed companies, principally in the UK. He has led Deloitte's involvement in more than 30 major restructurings since 2007. Mr Nicholson also acted as the Chairperson for the Plan Meetings. Mr Nicholson's first statement described the outcome of the Plan Meetings and the Plan Companies' compliance with the Convening Order. His second statement, filed in reply to the evidence of the AHG Landlords, addressed the relevance of an M&A process to the Restructuring and the adequacy of the information provided to the AHG Landlords;

iv) a statement from Mr Smith, a partner at Deloitte, also specialising in insolvency and restructuring. He has specific experience in the gym and leisure sector in addition to experience in the wider consumer industry. Mr Smith was the chief author of the Relevant Alternative Report. Mr Smith's evidence addressed certain criticisms made by the AHG Landlords of the approach taken by Deloitte and the Plan Companies to the Relevant Alternative Report; and

v) a statement from Mr Thornton, a partner at Grant Thornton and valuation expert. Mr Thornton is a chartered accountant who was responsible for establishing the specialist valuation department at Grant Thornton and, from 2014 to 2019, he was the global valuation lead for that company. He has specific experience of valuations in the health and fitness sector as part of more than 30 years of investment and advisory experience. Mr Thornton's evidence addressed certain criticisms made by the AHG Landlords of the approach to the GT Report which formed the basis for the valuations of the Plan Companies.

85. The evidence on behalf of the AHG Landlords was as follows:

i) five statements from Mr Jervis, a partner at PwC instructed on behalf of the AHG Landlords. Mr Jervis is an insolvency and restructuring expert with significant experience of restructuring processes, in addition to acting as an office-holder in several high-profile insolvencies. Mr Jervis's evidence set out his views on how he would manage the businesses of the Plan Companies in his capacity as an insolvency practitioner; the information he would require in order to advise the AHG Landlords of the effect of the Plans; and certain concerns with the basis upon which the Plan Companies had arrived at the Restructuring proposals (for example, without having conducted a full M&A or external fundraising process) and criticisms of the Deloitte Report; and

ii) two statements from Mr Mackenzie, also a partner at PwC instructed to advise the AHG Landlords. Mr Mackenzie has more than 25 years' experience working in corporate finance, with a background in M&A and debt restructuring. He was formerly a director at N M Rothschild & Sons Limited. Mr Mackenzie's evidence concerned, among other things, the desirability of conducting an M&A process and exploring the provision of alternative sources of funding; criticisms of the GT Report which called into question the reliability of the valuations obtained by the Plan Companies in respect of the businesses; and considering the relative treatment of different stakeholders under the Plans.

86. Parts of the evidence of Ms Hartley and Mr Thornton were given in private as they related to matters which I was satisfied were commercially sensitive and confidential to the Plan Companies and disclosure of which in open court would damage that confidentiality. I indicated, however, that I would review the extent to which the written evidence and the transcripts of the hearings in private could be made public after the end of the case.

87. During the course of the hearing, requests were also made by some of those attending pursuant to CPR 32.13 to inspect the witness statements which had stood as evidence in chief. The Plan Companies duly provided copies of the witness statements with suitable redactions of the parts considered to be confidential, which I was told had satisfied the requesting parties.

H. The Relevant Alternative Report and the GT Report

88. Before turning to the issues that I must decide, it is necessary to say a little more about the reports produced by Deloitte (the Relevant Alternative Report) and by Grant Thornton (the GT Report), as many of the evidential challenges made by the AHG

Landlords concerned the reliability of those reports and the information upon which they were based.

89. As I have described above, the Relevant Alternative Report was produced by Deloitte and concluded that the most likely alternative to the Plans was an administration in which the Secured Creditors would fund an accelerated sale process carried out by the administrators of the Plan Companies: this is Scenario 1 of the Relevant Alternative Report. Scenario 1 envisaged the separate sale of the Italian, APAC and UK businesses rather than a combined sale of the whole Group.

90. Deloitte calculated the likely returns to creditors in Scenario 1 principally on the basis of the valuations in the GT Report. At the time the Relevant Alternative Report was prepared, the GT Report was available to Deloitte in draft form. The valuations in the GT Report were going concern valuations on a debt-free basis and assumed a willing buyer and a willing seller in an orderly sale. The valuations were thus given on the basis that the businesses were continuing to operate and did not take into account circumstances which might have adversely affected the value achieved on a sale (for example, the requirement for the sale to take place on an accelerated basis in an administration).

91. Importantly, the valuations were "desktop" valuations: they did not result from a process of advertising or marketing the businesses for sale to potential purchasers. In this regard, the primary methodology adopted by Grant Thornton was a "discounted cash flow" ("DCF") methodology, which was then cross-checked against other valuation methodologies. The precise details of the methodology and cross-checks are complex, and it is only necessary here to describe the key features:

i) a DCF methodology is described as an "income approach", a direct valuation approach which values assets based on the future cashflows that the asset or business is expected to generate or save. Under this approach, forecast cashflows attributable to the asset or business are discounted to their net present value as at the valuation date;

ii) the method is intended to derive the intrinsic value of the asset or business based on its underlying financial performance and expectations. Among the key advantages of a DCF methodology, in the evidence of Mr Thornton, is that it is less affected by short-term uncertainties (such as those created by the pandemic) or one-off events than methods of valuation which rely on comparisons with similar businesses or transactions in the market;

iii) having obtained valuations using the DCF methodology, Grant Thornton then cross-checked those valuations using two methods: (i) a leveraged buy-out ("LBO") valuation; and (ii) a market multiple valuation;

iv) an LBO valuation seeks, in summary, to determine the price that would be paid by a financial buyer (such as a private equity fund rather than a trade purchaser) for a target company, with financing in the current debt markets, which would generate an appropriate return on its investment for the buyer. The main components of an LBO valuation are therefore: (i) the target company's current and projected free cash flows; (ii) the rate of return that private equity investors

typically seek when making investments; and (iii) the financing structure, interest rates and banking covenants likely to be required by lenders;

v) an implied market multiple valuation is a valuation approach based on publicly observable prices that were paid for similar businesses in the market. Given the significant uncertainty caused by the COVID-19 pandemic, Grant Thornton used historical data (from 2019), identifying nine broadly comparable listed companies to identify the relevant companies' share price and to derive from it an estimated enterprise value and EBITDA to obtain an enterprise value/EBITDA multiple in respect of 2019 earnings. After applying certain adjustments, the implied multiple derived from that exercise was compared with the implied multiples calculated for each of the regional businesses within the Group, in order to cross-check the valuation obtained from the DCF valuation.

92. The primary source of information for the valuations in the GT Report was the Group's business plan, which set out management's five-year forecast for each regional business. This included profit and loss, cashflow and balance sheet forecasts for each regional business. It provided actual data for financial years ending 31 December 2019 and 31 December 2020, and projected data for the period from 1 January 2021 to 31 December 2025. The forecasts had been prepared in January 2021 and were understood to represent management's best estimate of the financial position of the Group over the next five years. As is typical in such valuation exercises, Grant Thornton did not audit the information provided to them by management, but they did discuss and test with management the assumptions underlying the forecasts and the overall position of the businesses. Based on those discussions, Grant Thornton concluded that management's approach to forecasting and the assumptions used were reasonable.

93. The information obtained from management, as described above, was the "base case", and was used to produce Grant Thornton's "Base Case Valuation" in the GT Report using the methodologies and cross-checks I have described above.

94. At the time of the original GT Report, Grant Thornton was also provided with a further set of financial information and forecasts by management, reflecting the risk that the regional businesses would perform worse than anticipated on the "base case". The main adjustments to the "base case" forecasts were: (i) a reduction of 2.5% for each regional business for the period to 2025 to account for the risk of membership recovery underperforming expectations; and (ii) a reduction of 100% of the revenues attributable to the Group's digital offering. Grant Thornton used the adjusted forecasts to produce a "Downside Case Valuation", again using the methodologies and cross-checks I have described above.

95. Finally, on 13 April 2021, Grant Thornton was provided with updated information, forecasts and assumptions to the "base case", taking into account developments in the intervening period. On the basis of these updates, Grant Thornton produced an "Updated Case Valuation" in an updated report dated 19 April 2021. The Updated Case Valuation is important because the AHG Landlords suggested that it is the appropriate valuation to use when calculating the outcome of a sales process in administration in the relevant alternative.

96. As at the date of the Relevant Alternative Report, only the Base Case Valuation and Downside Valuation were available to Deloitte. As I have said, the Updated Case

Valuation was not produced until 19 April 2021, more than a month after the date of the Relevant Alternative Report.

97. In their report, Deloitte adopted a different approach to the likely proceeds of sale from the Italian and APAC businesses, on the one hand, and the UK business, on the other. The reasons for taking a different approach were described in the evidence of Mr Smith of Deloitte. In summary, the key reason was that Grant Thornton had valued the whole of each regional business on a going concern basis. In the case of the UK business, however, Deloitte considered that the relevant alternative was not a sale of the whole business (as was the case for the Italian and APAC businesses), but a sale of only the most profitable parts of that business. Accordingly, the valuation for the UK business in the GT Report was considered a less useful estimate of the value that would be obtained for that UK business in the relevant alternative.

98. In relation to the Italian and APAC businesses, Deloitte based its analysis of the likely sale proceeds on the Downside Case Valuation (rather than the Base Case Valuation). The rationale for this approach is described by Mr Smith as being that any putative purchaser in the relevant alternative would be more likely to base its investment decision and underwriting process on the Downside Case Valuation. Deloitte did not apply a further distress discount to the Downside Case Valuation figures, but cross-checked them to the Base Case Valuation figures less a distressed discount.

99. In relation to the UK business, Deloitte did not use the valuation in the GT Report but adopted a "*multiple based approach*" based on a number of assumptions, including that: (i) a purchaser would seek to acquire only Class A and Class B Leases based on the historical profitability of those sites; (ii) on assignment, any prospective purchaser would be required to settle rental arrears in relation to Class A Leases only (as these are the most profitable sites); (iii) as the Class B Leases are considered to be over-rented in most cases, an economically rational landlord of a Class B Lease would not hold out for rental arrears as a condition of assignment if they were offered contractual rent on those properties; (iv) an assignee of an over-rented Class B Lease would likely seek to renegotiate the future rent in respect of that Lease; (v) any offer made by a purchaser would be based on the "downside case" prepared by management for FY22, and an EBITDA multiple of between 2 – 4x would be applied. Deloitte did not apply a further distress discount as a result of the fact that using the "downside case" already reflected the distressed nature of the sale. However, as a cross-check, they applied a distress discount to Grant Thornton's Base Case Valuation for the whole of the UK business.

100. Adopting these approaches to the different regional businesses, Deloitte concluded that a sale of the Italian business was likely to realise £51 million; that the sale of the APAC business was likely to realise £67.4 million; and that the sale of the UK business was likely to realise £60.8 million. In each case, the figure selected was the midpoint of the estimated valuation range. The total estimated sale proceeds were £179.3 million which, when combined with "other realisations" of £44.3 million, gave a total estimated realisation of £223.6 million. This is £39 million less than the amount required to clear the secured debt and other priority claims, with the result that, on Deloitte's view, the unsecured Plan Creditors would be out of the money and the distributions to them in an administration would be limited to a *de minimis* share of the prescribed part.

I. The Issues

101. Section 901F of the CA 2006 provides as follows:

> "(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.
>
> (2) Subsection (1) is subject to -
>
> (a) section 901G …"

The power to sanction a plan under Section 901F in a case in which all classes vote in favour by the requisite majority in effect replicates the power exercised in relation to scheme under Part 26, where it is essential that each class votes in favour.

102. However, section 901G is entitled "sanction for compromise or arrangement where one or more classes dissent". So far as material, section 901G provides as follows:

> "(1) This section applies if the compromise or arrangement is not agreed by a number representing at least 75% in value of a class of creditors or (as the case may be) of members of the company ("the dissenting class"), present and voting either in person or by proxy at the meeting summoned under section 901C.
>
> (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.
>
> (3) Condition A is that the court is satisfied that, if the compromise or arrangement were to be sanctioned under section 901F, none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative (see subsection (4)).
>
> (4) For the purposes of this section "the relevant alternative" is 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.
>
> (5) 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."

103. In other words, section 901G provides that the Court may exercise its power to sanction a plan under section 901F notwithstanding that the arrangement has not been approved by the requisite majority in each class meeting of creditors, provided that conditions A and B are met. This power is generally referred to as a "cross-class cram down" and is the central issue in the instant case because, as indicated above, although the Plans were approved by the Secured Creditors and the Class A Landlords, they were rejected or failed to attain the necessary statutory majority in each of the other class meetings of Landlords in Classes B-E and the General Property Creditors.

104. Accordingly, where a company applies for the sanction of a restructuring plan in reliance on section 901G, three questions must be considered by the Court:

i) Condition A: If the restructuring plan is sanctioned, would any members of the dissenting class be any worse off than they would be in the event of the relevant alternative? This is often described as the "no worse off" test.

ii) Condition B: Has the restructuring plan been approved by 75% of those voting in any class that would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative?

iii) General Discretion: In all the circumstances, should the Court exercise its discretion to sanction the restructuring plan?

105. In the instant case, there was no dispute that Condition B was satisfied by the approval of the Plans by the Secured Creditors and by the Class A Landlords. The two issues are therefore (i) whether the "no worse off" test (Condition A) is satisfied, and (ii) whether the Court should exercise its discretion to sanction the Plan.

J. Issue 1: is the "no worse off" test (Condition A) satisfied?

106. The "no worse off" test can be approached, first, by identifying what would be most likely to occur in relation to the Plan Companies if the Plans were not sanctioned; second, determining what would be the outcome or consequences of that for the members of the dissenting classes (primarily, but not exclusively in terms of their anticipated returns on their claims); and third, comparing that outcome and those consequences with the outcome and consequences for the members of the dissenting classes if the Plans are sanctioned.

107. It is important to appreciate that under the first stage of this approach, the Court is not required to satisfy itself that a particular alternative would definitely occur. Nor is the Court required to conclude that it is more likely than not that a particular alternative outcome would occur. The critical words in the section are what is "*most likely*" to occur. Thus, if there were three possible alternatives, the court is required only to select the one that is more likely to occur than the other two.

108. Having identified the relevant alternative scenario, the Court is also required to identify its consequences for the members of the dissenting classes. This exercise is inherently uncertain because it involves the Court in considering a hypothetical counterfactual which may be subject to contingencies and which will, inevitably, be based upon assumptions which are themselves uncertain. It is, however, a familiar exercise. In Re

DeepOcean 1 UK Limited [2021] EWHC 138 (Ch) ("DeepOcean"), which I consider in more detail below, Trower J stated, at [29]-[30]:

> "29. I should say something about the relevant alternative. Identifying what would be most likely to occur in relation to the company if the plan were not to be sanctioned is similar to the exercise of identifying the appropriate comparator for class purposes in the context of a Part 26 scheme of arrangement: as to which see e.g. Re Telewest Telecommunications Plc [2004] BCC 342, 351; Re The British Aviation Insurance Co Ltd [2006] BCC 14 at [82] and [88] and Re ColourOz Investment 2 LLC [2020] EWHC 1864 (Ch) at [74].
>
> 30. It is also 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 company voluntary arrangement under section 6 of IA 1986. As Norris J explained in Discovery (Northampton) Limited v Debenhams Retail Limited [2020] BCC 9 at [12]:
>
>> "The authorities identify two useful heuristics for assessing whether a CVA is "unfairly prejudicial" under s.6(l)(a) . The first is commonly called "the vertical comparator". It compares the projected outcome of the CVA with the projected outcome of a realistically available alternative process, and sets a "lower bound" below which a CVA cannot go: see Re T&N Ltd [2004] EWHC 2361 (Ch) at [82] per David Richards J and Prudential Assurance Co v PRG Powerhouse Ltd [2007] EWHC 1002 (Ch); [2007] BCC 500 at [75]–[81] per Etherton J."

The relevant alternative

109. In the instant case, the Plan Companies contended simply that, as matters stand today, the evidence shows that if the Plans are not sanctioned, the Plan Companies would have no alternative but to go into administration.

110. The clearest evidence for this was given by Ms Hartley. The evidence was to the effect that although there have been some improvements to the Group's cash position, the liquidity pressure facing the Plan Companies remains severe. If the Restructuring (including the Plans) does not become effective this week, the Group is forecast to run out of cash, be forced to use its overdraft and be below the minimum amount of liquidity required to run its business by the end of next week. At that point, absent significant and immediate alternative funding – which Ms Hartley does not believe will be available – the Plan Companies will be forced to enter administration shortly thereafter.

111. I have summarised above the analysis undertaken by Deloitte in the Relevant Alternative Report. The conclusions of that report were summarised (and reiterated) in the evidence of Mr Smith of Deloitte. In short, he considered the most likely scenario in an administration, and the scenario most likely to maximise returns to creditors, would be an accelerated sale of the most valuable parts of the Plan Companies'

businesses. This is described as 'Scenario 1' and would entail a solvent share sale of the Italian and APAC businesses and a sale of the most profitable parts of the UK business (i.e., the sites operated from the premises subject to the Class A and Class B Leases). This evidence as to the current situation was not materially challenged by the AHG Landlords. Nor did the AHG Landlords challenge the proposition that the most likely shape of an administration would be an accelerated sale of the type described in Scenario 1.

112. Instead the AHG Landlords made a number of criticisms about the way in which the Plan Companies (advised by Deloitte) negotiated the Restructuring and arrived at the Plans. Among the specific criticisms advanced by Mr Dicker QC was that, in negotiating the terms of the Restructuring, the interests of the Shareholders were elevated above the interests of other stakeholders (including the Landlords as unsecured creditors). Mr Dicker QC submitted that this was part of a general pattern that the whole purpose of the Restructuring and of the Plans was to extract value from unsecured creditors, and to deny the Landlords any negotiating leverage, ultimately for the benefit of the Shareholders who stand to retain their equity and benefit from any future upside of the Plan Companies once they are restored to financial health. He characterised the position of the Landlords, who he said had been excluded from the negotiations, in colourful terms: "*if you are not sitting at the table, that is because you are lunch*".

113. Mr Dicker QC further submitted that the premise of the negotiations carried out by the Plan Companies was, at all times, that the Shareholders should remain in place and that at no stage was any form of competitive marketing or sales process undertaken, nor were any third-party funding options seriously considered in which Shareholders' equity was ever at risk.

114. The ultimate consequence of all of this, Mr Dicker QC submitted, is that having failed to explore seriously any other options, the Plan Companies are now presenting creditors (and, indeed, the Court) with a stark choice: accept the terms of the Plans developed principally for the benefit of the Shareholders or accept a distressed sale in insolvency. In substance, Mr Dicker QC submitted that the Plan Companies have effectively narrowed the options for their survival such that the only relevant alternative is now administration when, had they acted differently, other options might have been available.

115. At this stage of the analysis, I do not consider that it is necessary to consider whether the Plan Companies (or their directors) might have acted differently, or whether the way in which the Restructuring and the Plans were negotiated was in some way unfair to other creditors, or inappropriately elevated the interests of the Shareholders at the expense of the Landlords. That is because I accept Mr Smith QC's submission that the relevant question at this stage of the analysis is, simply, what is the relevant alternative now if the Plans are not sanctioned? I shall, however, return to pick up Mr. Dicker QC's points later in the judgment when considering the exercise of my discretion to sanction the Plans.

116. For present purposes, I therefore accept the evidence of Ms Hartley and Mr Smith which has not been challenged. The liquidity crisis facing the Plan Companies is so acute that not only is entry into administration what is most likely to happen if the Plans are not sanctioned, it is almost certain to happen. I am also satisfied that Scenario 1 is the most

likely way in which the administration would be conducted by administrators in pursuit of their statutory objectives.

117. Having identified what the relevant alternative is, I next turn to consider the likely consequences for Plan Creditors.

Preliminary observations – the procedure and provision of information

118. Before dealing with the detail of the valuation arguments, I should first consider the complaint by the AHG Landlords that they have been unfairly disadvantaged in their ability to challenge the Plan Companies, for example by being unable to conduct their own marketing process or producing their own valuations, by the uncooperative attitude of the Plan Companies and their advisers to the provision of information.

119. In this respect, Mr Dicker QC relied on six evidential points to suggest that the Plan Companies had conducted the process for these Plans in a way that made it difficult for the AHG Landlords to challenge the Plans. First, Mr Dicker QC pointed to the fact that Landlords were excluded from negotiations in respect of the Restructuring and the Plans, which he suggested was part of a deliberate plan on the part of the Plan Companies. Second, Mr Dicker QC submitted that when Landlords were first approached about the Plans at the beginning of February 2021, they were provided with little or no information. Third, Mr Dicker QC pointed to the refusal by the Plan Companies to provide all of the information and documents requested by Sullivan & Cromwell on behalf of the AHG Landlords. Fourth, Mr Dicker QC reminded me that the Plan Companies opposed the AHG Landlords' applications for disclosure at the Convening Hearing on the basis that everything that was relevant was contained in the Explanatory Statement, despite the GT Report not then having been provided (a copy was subsequently provided). Fifth, Mr Dicker QC indicated that the terms of the confidentiality undertakings required by the Plan Companies as a condition of sharing information and documents had prevented the AHG Landlords' advisers from discussing the contents with their clients, or with third parties to gauge potential interest in the Group. Sixth, and finally, Mr Dicker QC submitted that when PwC asked for information in the period leading up to the sanction hearing, many of those requests were refused. Instead, he added, certain documents which the Plan Companies had declined to provide were subsequently made available as part of the Plan Companies' reply evidence served a day before the hearing commenced.

120. Mr Dicker QC's submissions in this respect were put in several different ways, but in my judgment they all ultimately amounted to the same thing: a contention that the evidence before me is not the best evidence that I might have had if the Plan Companies had conducted the process differently, and that it is not (in any event) sufficient to discharge the burden placed upon them. Mr Dicker QC's proposition was, to some extent, also a defensive one. Among other things, it was intended to explain why I should not place too much weight on the fact that there was before me only one formal valuation of the Plan Companies' businesses (in the form of the GT Report), with no competing valuation evidence offered by the AHG Landlords.

121. In the absence of such competing evidence, the Plan Companies sought to characterise the evidence relied upon by the AHG Landlords as being, in essence, a series of "pot shots" against the evidence of the Plan Companies. Mr Smith QC described the complaints made by Mr Dicker QC as to the provision of information as "overblown",

and suggested that the evidence does not bear out the criticisms. By way of illustration, he took me to the correspondence between the parties following the Convening Hearing concerning the provision of information subject to appropriate confidentiality undertakings, and observed that the AHG Landlords' advisers did not appear to have acted with any real urgency after the hearing to agree the undertakings and obtain the information.

122. I do not accept that I can, as a matter of principle, do anything other than assess the Plans on the basis of the evidence before me, and I am not persuaded that my starting point should be to view the evidence of the Plan Companies with scepticism because of the difficulties the AHG Landlords claim to have faced in obtaining information.

123. Despite Mr Dicker QC's protestations, the reality is that the AHG Landlords, or their advisers, have been provided with an enormous volume of information and documents. To give just some examples, PwC has had access to the GT Report, the Relevant Alternative Report, the Explanatory Statement, the five-year business plans produced by management and supporting Excel models, 13-week cashflow forecasts, a breakdown of the Group's trading performance in 2019, and a meeting with the key individuals at Deloitte involved in advising the Plan Companies.

124. It is no doubt true that some of those documents were provided rather later than the AHG Landlords and their advisers might ideally have liked to receive them, but it does not follow from that complaint that I should thereby place less weight on the evidence of the Plan Companies, particularly where all of the parties have been operating to a compressed timetable in a matter of real urgency. The AHG Landlords are themselves sophisticated commercial parties and they have instructed experienced and sophisticated advisers who, as I observed in the Convening Judgment, are well able to operate in circumstances such as these to very tight deadlines. Whether that might be the case with less well-resourced parties in a future case is not a matter that I need to decide.

125. Moreover, in the Convening Judgment, I encouraged the parties to agree the provision of information subject to appropriate confidentiality undertakings. Mr Smith QC took me through the chronology, and it does appear that (in contrast to other creditors who had appeared) the AHG Landlords did not act immediately after the hearing with the urgency one might expect considering the position they now take and the significance they now attach to the issue.

126. Further, and in any event, I specifically envisaged in my Convening Judgment that if the AHG Landlords were dissatisfied with the disclosure given, or wished to disclose information to potential buyers on confidential terms, it was open to them to make an application to Court: see paragraphs [132]-[133]. As Mr. Smith QC submitted, there is force in the fact that no such application was brought. Moreover, the pre-trial review fixed for 19 April 2021 (ten days before the start of the sanction hearing) was a convenient opportunity for any outstanding issues relating to the provision of information to be raised, but it was vacated by the agreement of the parties.

127. As it is, I have one set of valuation evidence and one report analysing the relevant alternative from the Plan Companies. Against that, I have several lengthy statements on behalf of the AHG Landlords (principally from Mr Mackenzie and Mr Jervis, both of PwC) which seek to challenge the evidence of the Plan Companies. In addition to that

written evidence, the hearing commenced with more than two extended court days of cross-examination of the witnesses. Accordingly, the evidence of the Plan Companies was tested much more rigorously than is typically the case in Part 26 schemes or in any of the Part 26A plans that have thus far come before the Courts.

128. Taking all these circumstances into account I have concluded that it is appropriate and procedurally fair that I should proceed on the basis of the evidence before me.

129. Before leaving this issue, I would observe that the possibility of the Part 26A regime giving rise to valuation disputes was foreshadowed in the Department for Business, Energy & Industrial Strategy's response to the outcome of its consultation on "*Insolvency and Corporate Governance*", published on 26 August 2018 at paragraph 5.172:

> "Many respondents noted how contentious valuation can be, both in the UK's schemes of arrangement and the US's Chapter 11 proceedings. The Government acknowledges that disputes over valuation may result in costs and delay to restructuring plans being confirmed or not. The responses received indicate that it is highly unlikely that any standard chosen would completely remove the potential for dispute given the importance of the valuation in determining who may be crammed down. Even if a straightforward option, such as liquidation value, was used, that would not eradicate the possibility of creditors challenging a valuer's assessment based on factors such as valuation method employed. As a number of respondents pointed out, there are many valuation methods in common use so there will be different opinions as to which is the most appropriate, and creditors can challenge if they do not agree with the company's choice. Assets, such as intellectual property or goodwill, are difficult to value objectively and may lead to further dispute when valued for a restructuring plan. The Government's objective is to minimise the likelihood of challenge so far as is possible, whilst providing the underlying protection to creditors that such a safeguard is meant to offer."

130. As that response makes clear, it is obviously important that the potential utility of Part 26A is not undermined by lengthy valuation disputes, but that the protection for dissenting creditors given by the "no worse off" test (and the Court's general discretion) must be preserved.

131. To that end, as I indicated in the Convening Judgment, I consider that the Court is entitled to expect and require companies proposing Part 26A plans to cooperate in the timely provision of information. In an appropriate case this may include information over and above that which can sensibly be contained in a concise explanatory statement, but which may be relevant to the efficient resolution of genuine valuation disputes that have been raised by dissenting creditors.

132. It would also be most unfortunate if Part 26A plans were to become the subject of frequent interlocutory disputes. However, if a dissenting creditor is to rely on an argument that it did not have enough information with which to challenge the evidence

of a plan company, it will obviously be relevant to consider whether that dissenting creditor used the means legitimately available to it under the CPR to obtain the information prior to the sanction hearing.

The likely outcome and consequences for dissenting creditors in the relevant alternative

133. For the reasons given above, I have accepted the Plan Companies' evidence that the most likely relevant alternative to the Plans is a trading administration involving an accelerated sale of the regional businesses of the Plan Companies. It is now necessary to consider the most likely outcome of that relevant alternative for dissenting creditors.

134. The AHG Landlords submitted, for numerous reasons, that I cannot be satisfied that no member of any dissenting class will be any worse off in the relevant alternative than under the Plans. This is primarily a dispute as to valuation. It is clear as a matter of principle that the normal civil standard of proof applies to a valuation dispute: see, for example, the comments of Mann J in Re Bluebrook Ltd [2010] BCC 209 ("Bluebrook") at [25]. I proceed on that basis.

135. As a preliminary observation in this regard, it is worth bearing in mind the observations of the authors of *Howard & Hedger: Restructuring Law and Practice* ("*Howard & Hedger"*). In Chapter 5 of that work, the authors describe four business plan cases that are often used, together with up to six valuation methodologies. The four business plan cases are identified as (i) the base case, (ii) the downside case, (iii) the best case, and (iv) the sensitised case. The six key valuation methodologies are described as (1) comparable multiples, (2) a discounted cash flow method (often taking into account the four cases), (3) the LBO (Leveraged Buy-Out) Analysis, (4) Secondary Debt Market Pricing, (5) 'Market Testing' valuations based on bid interest and potential supply and demand and (6) a real estate valuation.

136. The authors then continue, at paragraphs 5.87-5.88,

> "5.87 In many restructuring scenarios the valuation tension will be fully played out by the senior and junior creditors and in certain cases the equity. Each stakeholder will argue that the value (based on the four cases and the six valuation methodologies outlined above) breaks within their constituency, such that they should receive the equity ownership in the newco if there is a necessary conversion of their impaired debt as part of a balance sheet restructuring. As a consequence it is becoming increasingly common for restructuring valuations to be driven by the four cases and where relevant as many of the six valuation methodologies as is appropriate. Indeed, in most consensual restructurings the valuation that is eventually prescribed and the allocation of equity in a newco will be the product of intense negotiation and each stakeholder is likely to engage professional accounting, valuation and investment banking advice to substantiate its position. Such creditors will invariably resort to a combination of these valuation techniques to support their case. A good example of this was the Stabilus case where [the] security trustee came to the view on the basis of legal advice, that it needed four different sorts of valuation: (i) a

> benchmark multiple of earnings analysis (adjusted to reflect the current market environment); (ii) a DCF valuation; (iii) a leveraged buy out valuation and (iv) a market tested valuation. In that case the security trustee opted to get the first three of those valuations in the form of desk-top exercises, from one valuer, and to rely on [a bank] (who had historically conducted market testing) for the market tested valuation.
>
> 5.88 In cases where subsequent litigation ensues as a result of a restructuring implementation, where there is a court process such as a scheme of arrangement where it is claimed that a party has no economic interest or value, or an administration where there is to be a pre-packaged sale, a court will face the same uncertainties in a valuation and may well need to take into account the depressed nature of the company's sector and the future strategy of prospective buyers. A court will therefore have to analyse and appraise the valuation evidence proffered by each interested party and the detailed assumptions upon which it is based. In doing so the court will need to be cognisant of the strategic incentives to overvalue or undervalue the company's business."

I bear in mind those observations.

137. Against that background, Mr Dicker QC first submitted that there were two overarching reasons why I could not be satisfied that the "no worse off" test was met. First, he submitted that the estimated outcome for creditors under the relevant alternative, as set out in the Relevant Alternative Report, is inherently unreliable by reason of the fact that the returns were not tested by any form of sales or marketing process to test the market for the businesses of the Group. Second, he submitted that it is not possible for the Court to be satisfied that the conclusions reached in the Relevant Alternative Report are accurate or reliable, given the scope and limitations of that report and the information on which it was based.

(i) *No market testing*

138. I have explained above that the GT Report was based on a "desktop" valuation and that neither the Plan Companies nor their advisers conducted a marketing or price discovery process. Mr Dicker QC, by reference to the evidence of both Mr Mackenzie and Mr Jervis submitted that this approach was fundamentally wrong. He said that a market testing process should have been conducted and, if it had been conducted, would have offered a more reliable basis on which to form a view of the 'true' value of the businesses of the Plan Companies.

139. The starting point in assessing this argument is that there is no absolute obligation to conduct a market testing process as part of a restructuring. There is no authority for the contrary proposition, either in the legislation or any other authority to which I was referred, and Mr Dicker QC did not contend otherwise. Indeed, in Saltri III Ltd v MD Mezzanine SA Sicar [2012] EWHC 3025 (Comm), which was litigation that followed the Stabilus case concerning the restructuring of a distressed business through a security enforcement to which the authors of *Howard & Hedger* referred, Eder J rejected an

argument from a dissenting creditor that a full market testing process ought to have been carried out. Having considered the authorities, he stated at [149]:

> "… I do not accept that there was any absolute obligation of the kind alleged ... In particular, I do not accept that there was any absolute obligation … to carry out a 'marketing and sale process' or 'market testing process' or other kind of 'bidding process'."

140. On the basis that there can be no absolute obligation to conduct a market testing process, the question is then whether it was necessary or practicable in the circumstances of the instant case for the Plan Companies to have done so as part of proposing the Plans. That question also raises the issue of whether such an exercise would be likely to have resulted in a materially more reliable valuation than the approach adopted by Grant Thornton.

141. I am not persuaded on the evidence that such a process would have met any of these tests. I am certainly not persuaded that it was unreasonable for the Plan Companies to follow the advice of their advisers, who did not recommend such a process. I reach this conclusion for a number of reasons.

142. First, although Mr. Jervis suggested in his evidence on behalf of the AHG Landlords, that market testing processes are undertaken "*habitually*" in relation to restructurings, I was not shown any persuasive evidence that this is the case. Indeed, Mr. Jervis was taken in cross-examination to the explanatory statement for a current Part 26A plan being proposed in Scotland in relation to Premier Oil plc, in relation to which PwC has been engaged to provide a report on the likely returns to plan creditors in the event of a stressed sale or hypothetical insolvency of the group concerned. Mr. Jervis acknowledged that this was equivalent in scope to the work done by Deloitte and Grant Thornton in the instant case. It is clear from the PwC report included in the explanatory statement for Premier Oil plc that PwC had not conducted a market testing exercise, but had instead,

> "…performed an illustrative desktop exercise of the recoverable value of the assets of the key operating entities, as well as a wider balance sheet review of these entitled and the remainder of the group."

The PwC report also emphasised,

> "Our valuation analysis is illustrative in nature and has been prepared on a desktop basis. The valuation does not represent the market value of the group as a whole on a going concern basis but rather reflects the scenarios we have considered.
>
> …
>
> We have not performed an audit, market study, due diligence on management's assumptions and model nor a review of the market as part of our work. Our work does not constitute an advice, an opinion or assurance."

143. Against that evidence, far from market testing processes being used "habitually", Mr Nicholson's evidence was that in his experience, the opposite was true, and only a minority of restructurings in which he had been involved had included any form of sales and marketing process. An admittedly unscientific sample of my own experience hearing such cases, together with the collective experience of the three counsel who appeared before me, also did not reveal a uniform practice.

144. Second, as a simple practical matter, Mr Nicholson's evidence was that it was wholly unclear how the funding for such a process would have been obtained in the instant case. The Plan Companies were plainly running short of cash, and it was Mr Nicholson's belief, particularly in January 2021, that neither the Shareholders nor the Secured Creditors had any appetite to fund such a process. I have no reason to doubt that evidence.

145. Third, and to my mind, persuasively, the evidence of both Mr Smith and Mr Thornton was that the fruits of any market testing process in the instant case would have to be treated with extreme caution. This is essentially because it would have required the Plan Companies to offer their gym and leisure businesses for sale at a time in early 2021 when substantially the whole sector was closed for an indeterminate period due to the pandemic, and had been closed for most of the preceding year. The market into which such testing would have been done could hardly have been less favourable.

146. Even if they could be persuaded that the process was a genuine one which might lead to a sale, potential buyers in the same sector would be suffering the same issues caused by the pandemic and might well be unwilling to commit the substantial resources and time needed to make a serious bid that could be relied upon as an indication of the price at which a transaction would ultimately be consummated (and, as Mr Smith observed, the price that someone in fact pays for the business is the only way of proving value with certainty).

147. Indeed, this was essentially the same criticism levelled by the claimant mezzanine creditors in Saltri III Ltd (above) who argued that a marketing and sales process carried out by the bank (the valuation derived from which was relied upon by the security trustee proposing the restructuring) was done to a tight timetable during a 'holiday period', such that it inevitably resulted in an unreliable, and low, valuation.

148. Similar concerns over the outcome and potential unfairness of market testing in depressed markets have also been voiced by commentators in the restructuring field. The authors of *Howard & Hedger* comment on the difficulties of conducting a market testing process in relation to the business of a distressed company in abnormal markets in paragraphs 5.70 and 5.71,

> "5.70 If the true nature of a company's distress had not been evident during a due diligence process, it is possible that such bids may initially value the company on the high side and this may well result in lower revised bids as the bid process develops. Certain stakeholders depending on their motivation and negotiating stance may of course contest the valuation being ascribed to the business via indicative bids and may argue that they are opportunistic and ill-informed. …

> 5.71 In normalised and liquid markets such as 2006, as opposed to late 2008–2011, buyer quotes may be the most reliable indicator of value. However, in markets like 2008 and 2009 specifically, market tests may not be determinative in establishing fair value. In [Bluebrook/IMO] the M&A process produced only one indicative offer which placed a value on the enterprise of £150m to £188m on a cash and debt free basis. This was not considered by the board to be an appropriate level of interest, or a worthwhile level of cash, to take further. In certain restructurings during this period both company boards and certain subordinated creditor stakeholders formed the view that testing the market and seeking bids in such a recessionary environment with macro financial distress may actually cause more harm to a company's reputation, revenues, and ultimately its valuation and was actually a self-fulfilling prophecy being strategically pursued by those creditors seeking to drive the valuation down and ultimately own the company."

149. Similarly, in *Debt Restructuring and Notions of Fairness* (2017) 80(4) MLR 600, Professor Sarah Paterson considered the approach traditionally taken in scheme cases such as Bluebrook to creditors who are left out of a scheme on the basis that they would be out of the money in a formal insolvency (an issue to which I shall return below). She commented, at page 614,

> "However, a party who is left outside the scheme can appear at the sanction hearing to argue that the scheme is unfair because the class of creditor of which she is a member should properly have been offered something within it. The English court will address this question by determining whether the creditors who have been left out of the scheme retain an economic interest in the company so that they should have been offered some consideration in it. *In determining whether the creditors have such an economic interest, the English court puts particular weight on the position the creditors would be in if the scheme of arrangement were not sanctioned. Where the company is financially distressed, this typically leads to an inquiry into whether the price which an administrator would receive in a market sale of the business and assets at the time of the restructuring would be sufficient to make a distribution to the creditors excluded from the scheme. However, asset prices may be generally depressed if there has been a slowdown in the business or finance cycle. This means that even though the current market price may indicate that the excluded creditors have no economic interest in the company, if the other creditors receive all of the equity in the company in exchange for their debt in the scheme of arrangement they may make a significant profit when asset prices recover.*
>
> *To address this concern, US bankruptcy law adopts a valuation standard based on professional valuation opinions, rather than*

> *current market price established through an auction process.* Thus it does not decide who should receive an equity allocation in the debt restructuring based on the current price in the market, but rather adopts traditional valuation techniques such as discounted cash flow, comparable transaction and private equity valuations in an attempt to give more credit for the prospect of a post-restructuring recovery in the price of the business and assets than a purchaser in the distressed market at the time of the sale might be willing to give."
>
> (my emphasis)

(ii) *Limitations in the Reports*

150. Mr Dicker QC's second point was that there was obvious uncertainty underlying the valuation evidence relied upon by the Plan Companies. He made the point in a number of ways, but perhaps most strongly by reference to the following disclaimer in the GT Report:

> "The outbreak of coronavirus (COVID-19), declared by the World Health Organisation as a Global Pandemic on 11 March 2020, has impacted global financial markets and created market uncertainty. A valuation is an estimate drawn from a range of possible outcomes based on the assumptions made in the valuation process. As at the Valuation Date due to the circumstances in which we are faced, *the degree of uncertainty in our valuation falls outside the range that might normally be expected and accepted*."
>
> (emphasis added)

151. Similar caveats were to be found in Deloitte's Relevant Alternative Report which included the following:

> "It is clear from the range of outcomes [in the GT Report] that valuations in the current market are hugely uncertain. This uncertainty is further heightened given the distressed nature of the disposal in the circumstances."

152. The terms in which those disclaimers and caveats are expressed is, at first blush, rather striking. Mr Dicker QC submitted that the degree of uncertainty expressed in both of the reports is so great as to undermine entirely any reliance that might be placed upon them. Mr Dicker QC urged me, in particular, to read into the words of the GT Report that not only are the valuations outside the range that might normally be *accepted*, but that they are outside the range of what is *acceptable*.

153. Despite Mr Dicker QC's criticisms, I do not consider that the inclusion of the disclaimers and caveats in either report is of real significance. The disclaimers bear all the hallmarks of having being inserted without sufficiently clear thought about the wording and the context in which the reports were likely to be used in these proceedings, together with a defensive over-abundance of caution designed to protect

the firms concerned from claims against them in the event that matters did not turn out as predicted.

154. I also note that similar disclaimers and caveats appear in the PwC report produced in relation to Premier Oil plc. Whilst understandably stressing that such statements were designed to ensure that no actionable duty of care was assumed by PwC to creditors, Mr. Jervis did not suggest that the report in question could not be relied upon commercially by plan creditors or by the court.

155. Moreover, although Mr. Thornton was taken to the disclaimer set out above, he was not in fact asked any specific questions about it. Nor was the point that there were too many inherent uncertainties for the GT Report to be relied upon ever actually put to him directly. He was, however, asked a more general series of questions on his approach to valuation and confirmed that he would do his best to come up with the right answer on the assumptions and evidence,

> "Q. And any valuation of the sort that your firm did is obviously critically dependent on the assumptions that go into it?
>
> A. Yes. That is right.
>
> Q. And in circumstances like the present, small changes and assumptions can lead to large differences in conclusions?
>
> A. Possibly. It depends on which assumptions change.
>
> Q. Obviously, depending on that, the range of outcomes can be considerable, and even capable of being broader than is acceptable?
>
> A. I think, when we undertake these kinds of exercises, we have to sort of do our best to sort of come up with what we think is the right answer on assumptions that we can see and on the evidence we have in front of us.
>
> Q. Absolutely. And if the position is uncertain, then the best you can do is convey what you think the number is; yes?
>
> A. Yes. That is right."

156. In his evidence, Mr Smith also accepted that any valuation is subject to a degree of uncertainty, but he did not agree that the caveat set out above from his Relevant Alternative Report meant that the higher level of uncertainty in the instant case was so great that it was not a safe or reliable basis upon which to proceed. He explained,

> "I think uncertainty runs both ways. You can have a higher return [or] a lower return. The level of uncertainty probably means [a] greater spread [but] not necessarily a different mid-point. I think

> that the best and indeed only basis we have for developing a relevant alternative is based on the professional valuation."

157. The point is that valuations will invariably produce a range of possible outcomes, and it is for the professional advisers to identify, within that range of outcomes, the most likely outcome. The mere existence of a broad range is not *per se* unreliable.

158. In addition, Mr. Jervis accepted in cross-examination that it was reasonable for Deloitte in the instant case to rely upon the DCF analysis produced by Grant Thornton (based upon information supplied by management), in order to produce the Relevant Alternative Report. Mr. Jervis also accepted that although he had not reviewed the Grant Thornton Report, it did not strike him as unreasonable to use a DCF methodology or approach.

159. In my judgment, notwithstanding the uncertainties and the disclaimers, as a general proposition the valuations and calculations in the GT Report and the Relevant Alternative Report appear to be reasonable and are capable of being relied upon for the purposes of determining whether to sanction the Plans.

The detailed criticisms of the valuation evidence

160. A number of more detailed and technical points were taken against the valuation evidence relied upon by the Plan Companies. The thrust of these criticisms, primarily advanced in the evidence of Mr Mackenzie, was that the estimate of the expected proceeds of the sale of the regional businesses was overly conservative, chiefly for the following reasons:

i) first, the valuation multiple implied by the Downside Case Valuation was too low, such that it was more appropriate to use the figures in Grant Thornton's Updated Case Valuation when calculating the value of the business. Had this approach been adopted, the hypothetical sale would have generated a surplus for unsecured creditors;

ii) second, the weighted average cost of capital ("WACC") and long-term growth rates ("LTGR") used by Grant Thornton in preparing its report were unduly conservative. Had small adjustments been made to these assumptions, the hypothetical sale would again have generated a surplus.

(i) <u>The appropriate Case Valuation</u>

161. In relation to the first criticism, Mr Mackenzie's evidence was that, if the figures in the Updated Case Valuation had been used, the result would have been to produce a net surplus value for unsecured creditors of £72 million from the sale of the Italian, APAC and UK businesses. Mr Mackenzie's conclusion in this respect depended critically on showing that the Updated Case Valuation is already so conservative that it is not necessary to apply a further discount to reflect the fact that any sale would be taking place in administration.

162. To succeed on this point, Mr Mackenzie would need to show two things: first, that it is more appropriate to rely on the Updated Case Valuation than the Downside Case Valuation used in the Relevant Alternative Report; second, that it is not necessary to apply a distress discount to the figures derived from the Updated Case Valuation.

163. The decision to use the Downside Case Valuation in the Relevant Alternative Report was explained in the evidence of Mr Smith. The Base Case was based on information and forecasts produced by management at a time of significant uncertainty. By the time the Relevant Alternative Report came to be produced in March 2021, the forecasts underlying the Base Case Valuation were already undeliverable as a result of delayed re-openings in Italy and the UK – this is borne out by the unchallenged evidence of both Mr Smith and Ms Hartley.

164. Mr Smith's view was that any putative purchaser of the relevant businesses would not base an investment decision on an outdated base case. For that reason, in determining the likely proceeds from the sale of the regional businesses, Deloitte relied upon the Downside Case Valuation in the case of the Italian and APAC businesses. However, that was not appropriate for the UK business because Grant Thornton had assumed a going concern sale of the UK Business as a whole, but Deloitte considered that an administrator would only seek to sell the most profitable Class A and B sites. Accordingly, Deloitte applied a multiple to the EBITDA for the financial year 2022 downside case produced by management. I accept that this approach was reasonable.

165. As I have explained above, the Updated Case Valuation on which Mr Mackenzie suggested the relevant alternative analysis ought now to proceed was not produced until shortly before the hearing on 26 April 2021. The Relevant Alternative Report was produced at the start of the Part 26A process more than a month earlier and had not been updated to reflect the new work undertaken by Grant Thornton. In cross-examination, Mr Smith referred in passing to further work undertaken by Deloitte based on the Updated Case, but that work had not been adduced in evidence.

166. Although I accept in principle that Mr. Mackenzie was entitled to refer to the Updated Case Valuation, for the reasons that follow, I do not accept his suggestion that, if the Updated Case Valuation were to be used, it would not be necessary to apply a further distress discount to the updated valuations given by Grant Thornton, and hence that the unsecured Plan Creditors would be in the money in the relevant alternative.

167. Grant Thornton's valuation exercise was conducted on the premise that the sale of the businesses would take place between a willing buyer and a willing seller in an orderly market. The need to apply a distress discount to the valuations calculated by Grant Thornton was made clear in <u>both</u> the original GT Report <u>and</u> the updated valuation report. The requirement was expressed in the same terms in each case:

> "Due to the ongoing liquidity challenges and urgent funding needs faced by the Group in the event of a distressed sale, e.g. limited to a three to four week sales process, we consider that a discount of up to 30% to the going concern Enterprise Value would not be unreasonable".

168. It was also clear from the written and oral evidence of Mr Thornton, that in relation to both the Base Case Valuation and the Updated Case Valuation, a distress discount would therefore need to be applied if the sale in question was to take place on an accelerated basis, and a greater discount would be applicable if this was also a sale in an administration. The reasons for that would include that a sale in an administration would take place on an expedited basis by administrators under a statutory duty to carry out their functions as quickly and efficiently as is reasonably practicable (not least because continued trading would require funding). Moreover, a sale by administrators gives rise to a number of other significant challenges, including that administrators almost invariably do not give representations and warranties on the sale of assets, a factor that is highly likely to reduce the price achieved on a sale.

169. Mr Smith's unchallenged evidence, consistent with the evidence of Mr Thornton and both the GT Report and the report containing the Updated Case Valuation, was that,

> "a distressed discount of between 30% to 50% would be likely to apply to sales … in the Relevant Alternative."

170. Mr Mackenzie advanced two arguments against applying any distress discount to the Updated Case Valuation, which he contended was already conservative or "low enough". The starting point for each of Mr. Mackenzie's arguments is that the valuation obtained from the Updated Case Valuation implies a 5.2x multiple of EBITDA.

171. Mr. Mackenzie's first point compared that implied 5.2x multiple against the range of multiples which Grant Thornton had derived from published information related to

companies which it considered broadly comparable to the regional businesses when cross-checking their DCF valuations. Those comparables produced a range of multiples between 5.6 and 8.9 for the regional businesses, with a mid-point of 7.3.

172. Mr. Mackenzie's second point was that the implied multiple of 5.2x was the same as that of Town Sports, a US company in the same sector which was "currently going through a debt restructuring process". The implication was that an EBITDA multiple of that number would therefore already reflect a distressed business.

173. I am unable to accept Mr Mackenzie's arguments, neither of which are in my view sufficiently persuasive to displace the Plan Companies' evidence as to the appropriateness of applying a distress discount.

174. As to the first argument, it is important to bear in mind that the market multiple methodology was merely one of the cross-checks used by Grant Thornton in preparing its valuations. The primary methodology used by Grant Thornton was a discounted cash flow (DCF) analysis, which did not appear to be seriously challenged by the AHG Landlords.

175. Mr Thornton's evidence was that using a DCF valuation was the most reliable method in the current COVID-19 environment because it is a direct valuation approach which values an asset on predicted future cash flows and is particularly used where there are erratic cash flows or growth patterns. He also explained that it was not appropriate to use the market multiple method as the primary method of valuation because of the uncertain market environment and the lack of good quality comparators in the regions where the Group operates.

176. Mr Thornton explained the relationship between the two methods,

> "Notwithstanding the limitations in this valuation methodology [i.e. the market multiple valuation], under the current circumstances this analysis and cross check broadly supported the results of our DCF Valuations".

177. At best, therefore, Mr. Mackenzie's first point was attacking an element of Grant Thornton's cross-check rather than its main valuation.

178. Mr. Mackenzie's second argument was based upon a comparison with the implied EBITDA multiple of Town Sports, a US business in the same sector and comparable in some ways to the Group, that is currently going through a debt restructuring process (which I assume to be Chapter 11) and had the same implied EBITDA multiple of 5.2x. The AHG Landlords suggested that this was evidence that the same multiple, when applied to the Plan Companies, must already adequately reflect the distressed nature of the Plan Companies' businesses.

179. That analysis appears to me to be flawed. The key point is that Town Sports is currently going through a *debt restructuring process*. That does not suggest to me that it is currently involved in the *distressed sale of its business* in a formal insolvency, which is what I have concluded is most likely to occur in the relevant alternative. Without further detail, I cannot conclude that it would be inappropriate to apply a further distress discount to take account of the difference between an on-going debt restructuring

process, which is presumably intended to improve the balance sheet of the company as a going concern, and a scenario in which a debt restructuring process fails, leading to a formal insolvency and an accelerated sale of the business by administrators.

180. Third, in submissions, the AHG Landlords pointed to the fact that Deloitte's Christmas Eve Report used a 9x EBITDA multiple to illustrate the possible sale proceeds of the regional businesses in a non-distressed scenario. The implied 5.2x multiple is a 42% discount to that multiple in the Christmas Eve Report and the 3.9x multiple implied by the Relevant Alternative Report is a 57% discount to that multiple. This point does not appear to me to go anywhere. The Christmas Eve Report, as the AHG Landlords acknowledge, was expressly premised on a solvent sale of the business. It is obvious as a matter of principle that a discount would need to be applied to that multiple, and I have been provided with no basis on which to conclude that a 42% discount to the illustrative multiple for a solvent sale is the right discount whereas a 57% discount is excessive.

181. Further if (as I have concluded would be the correct approach) one applies a distress discount to the Updated Case Valuation, there is only one scenario in which any surplus value for unsecured creditors (of approximately £9 million) could be generated, namely, if one applies the lowest suggested distress discount (of 30%) to the highest valuation point in the Updated Case Valuation. In light of Mr Smith's evidence that the most likely outcome is typically the midpoint between two extremes (which I accept), that outlier scenario appears to me inherently unlikely.

(ii) <u>Sensitivities to WACC and LTGR</u>

182. Mr Mackenzie's second main challenge to the valuation evidence started from the premise that very small changes to valuation assumptions can have a material impact on the overall enterprise valuation. This proposition is uncontroversial. In this respect, Mr Mackenzie's evidence was that the values used for WACC and LTGR by Grant Thornton were, respectively, too high and too low. Mr Mackenzie suggested that a small adjustment to each such that they are consistent with information in the public domain in respect of SATS Group was appropriate and that those adjustments again produced a surplus value for unsecured creditors. Mr Mackenzie identified SATS Group as a useful comparator because it is described as such by Grant Thornton as part of its cross-checks in the GT Report.

183. These criticisms appear to me wholly unpersuasive. It is plainly the case – as Mr Thornton said and as Mr Mackenzie accepted in cross-examination – that in constructing an independent valuation of a business, it would not be appropriate simply to rely on figures used by comparable companies (here, SATS Group) which, as Mr Thornton also said, may have been produced under entirely different circumstances or for entirely different reasons. Rather, an independent valuation would necessarily be constructed from first principles. That is what Mr Thornton did, and I therefore accept his evidence in this respect in the absence of any compelling reason not to do so.

184. For the foregoing reasons, I do not consider that any of the AHG Landlords' criticisms of the Plan Companies' valuation evidence is sufficient to displace that evidence. I am satisfied that the valuation exercise conducted by Grant Thornton, and set out in the GT Report, was reasonable and that it was also reasonable for Deloitte to rely upon the GT Report to the extent that it did in the Relevant Alternative Report.

185. In reaching these conclusions, I also place some small weight on the fact that, in contrast to Mr. Thornton, Mr Mackenzie is not a valuation expert and would not have been the person tasked with producing an independent valuation of the business had the AHG Landlords decided to conduct that exercise. Indeed, Mr Mackenzie referred several times in his evidence to discussions with a "*valuation team*" at PwC who were not put forward to give evidence.

Non valuation factors

186. Finally in respect of Issue 1, Mr Dicker QC relied upon the evidence of (primarily) Mr Jervis to suggest that there were two additional reasons that the Court could not be satisfied that no creditor would be "*any worse off*" under the Plans than in the relevant alternative.

187. First, in calculating the likely outcomes for Landlords in the relevant alternative of Scenario 1, Deloitte relied upon a report from Mason & Partners LLP. The Mason & Partners report was requested on behalf of the AHG Landlords but was not provided to them. The request was not pursued with much vigour by Sullivan & Cromwell when it was originally made in March 2021, but that request was renewed on 22 April 2021.

188. The report itself was never disclosed to the AHG Landlords and is not evidence. Instead, the Plan Companies provided a schedule setting out, against each Lease, the current rent (i.e. contractual rent), lease expiry date, estimated rental value (ERV) (i.e. market value), projected void period and projected rent-free period, together with a number of (largely incomprehensible) comments. The origins of the schedule are unclear, but I have no reason to doubt that it reflects the outcome of the fuller report by Mason & Partners.

189. The significance of the report (and the schedule) is that it informs Deloitte's views about the likely outcomes for Landlords in the relevant alternative of Scenario 1. It will be recalled that, in Scenario 1, Deloitte identified what is most likely to happen in respect of the Leases held by each Class of Landlord. For Class A Landlords, in the relevant alternative they would likely recover their rental arrears and obtain an assignment at contractual rent; for Class B landlords, they are thought likely to agree an assignment of their Lease at somewhere between contractual and market rent, but to forgo rental arrears as a condition of assignment; for Classes C through E, the most likely outcome is said to be that the administrators will choose not to market the sites for sale at all.

190. The first challenge to this part of the Relevant Alternative Report was that the Mason & Partners analysis is inherently unreliable. Mr Dicker QC pointed, for example, to the lack of clarity about the basis upon which Mason & Partners had conducted their analysis. To take just one example, Mr Dicker QC took me to a page of the Relevant Alternative Report in which it was implied that "dilapidations" were not considered as part of the calculations, notwithstanding that the impact of dilapidations on the claims of Landlords might be "significant".

191. This challenge can be dealt with fairly shortly. The AHG Landlords have always been in a position to adduce evidence as to what they think they would get in the market for their properties by way of rent or arrears, but have elected not to do so. Landlords have known since, at the latest, the promulgation of the Practice Statement Letter on 10

March 2021 of the proposed treatment of their Leases under the Plans. If any Landlord genuinely believed that they could obtain a demonstrably better deal than in the relevant alternative, they have had ample opportunity to adduce evidence to that effect. In the absence of any such evidence, it is unnecessary to explore the point any further.

192. The second challenge to the Relevant Alternative Report concerns, primarily, the Class B Landlords. This challenge was advanced in evidence by Mr Jervis and is, in essence, that whereas the Relevant Alternative Report concludes that Class B Landlords would forgo rental arrears as the price of an assignment on a sale by administrators, the reality might be different. This is the result of what Mr Jervis said would be the negotiating leverage held by those landlords which would enable them to hold out for payment of their rental arrears. On this hypothesis, the Class B Landlords would be worse off under the Plans because they would have lost the opportunity to seek a higher level of rent and to recover arrears.

193. Mr Dicker QC took me again to the Mason & Partners schedule, and observed that the difference between the contractual rent and the estimated market rent for some of the Leases was relatively narrow. In light of that, he submitted, it was not inconceivable to believe that in the relevant alternative of a sale in administration, a Landlord might be able to extract as the price for assigning the relevant Lease a higher rental value or, indeed, some contribution towards arrears.

194. Mr Smith QC submitted that the challenge advanced in this respect was misplaced because it exaggerated the extent of the bargaining power of (in particular) Class B Landlords. The evidence of Mr Smith of Deloitte was consistent with this. He agreed with Mr Jervis that the matter would essentially be resolved by commercial negotiation. However, he observed that the starting position of a putative purchaser of a Lease would be that they would pay rent at market rates. Based on the work of Mason & Partners, those market rates are almost invariably lower than the contractual rates which Class B Landlords will receive under the Plans. Whilst it is correct that a Landlord in the relevant alternative may, in theory, elect to decline consent to an assignment of the Lease, that approach carries with it obvious and significant downsides – for example, the property may very well be subject to a void period and, moreover, it would not be capable of being re-let to a third party as a functioning gym business because the Landlord could not assign the equipment or the customer base. They would, in effect, be marketing a 'shell'.

195. I accept the evidence of Mr Smith that the approach most likely to be taken by a Class B Landlord in the relevant alternative, behaving in an economically rational way, would be to consent to the assignment of the lease at somewhere between market and contractual rent, and not to decline consent in the hope of recovering rent arrears from a new purchaser. It is not impossible that this could happen, but nor do I accept that it is what is most likely to happen.

196. I should add, for completeness, that at the end of the hearing, Mr Dicker QC drew my attention to correspondence from the legal advisers to a Class B Landlord who explained that their client had served forfeiture proceedings on one of the Plan Companies during the hearing. That appears to have been a rather opportunistic attempt to bolster the AHG Landlords' argument that some Landlords could achieve a better outcome than in the relevant alternative (in this case, presumably by forfeiting the property and re-letting it for a higher rental value). I place no weight on that

correspondence since it was not properly in evidence and note, in any event, that the Plans do not purport to compromise any accrued right of forfeiture.

Would any of the dissenting creditors be any worse off under the Plans?

197. To summarise, based on my consideration of the available evidence and as set out above, I have arrived at a number of factual conclusions. First, the most likely relevant alternative to the sanctioning of the Plans is that the Plan Companies will enter administration and the administrators will pursue an accelerated sale of the businesses on a regional basis in the manner suggested by Deloitte under Scenario 1. Second, that the valuation evidence adduced by the Plan Companies, as reflected in both the GT Report and the Relevant Alternative Report, is reasonable and there is no basis upon which to impugn it, despite the criticisms advanced by the AHG Landlords. Third, that the evidence as to estimated rental values of the Leases contained in the Mason & Partners report is the best available evidence on that topic and that there are no good grounds on which to doubt it. Fourth, that the terms of the assignment of any Lease belonging to a Class B Landlord as part of a sale of the UK business in administration will be a matter of commercial negotiation, but that it is most likely that an economically rational Landlord will agree to assign the Lease at somewhere between contractual and market rent, and will not require (or obtain) payment of arrears as a condition of assignment in the relevant alternative.

198. Bearing in mind those factual findings, I now turn to consider in respect of each dissenting class of Plan Creditors whether they would be any worse off under the Plans than in the relevant alternative.

199. I have summarised above in Section D how each class of creditor is to be treated under the Plans. As to how each dissenting class is likely to fare in the relevant alternative:

i) in relation to Class B Landlords, as I have found above, in the relevant alternative of administration, an economically rational Class B Landlord is most likely to agree to the assignment of its Lease for somewhere between market and contractual rent, and would not demand payment of arrears as a condition of assignment. Class B Landlords would have an unsecured claim in the administration for payment of unpaid arrears, and would likely be paid a dividend (limited to a share of the prescribed part) between 18 months to 2 years after the date of administration;

ii) in relation to Classes C through E Landlords, the most likely outcome in the relevant alternative is that the administrators would choose not to market the clubs (because they are all forecast to be unprofitable), and would instead surrender the properties to allow the relevant Landlord to re-let them to a new tenant (or, in the case of Class E Landlords, enter a new deal directly with the sub-tenant). In each case, the Landlords would have an unsecured claim in the administration for payment of unpaid arrears and loss of bargain in respect of future rent, together with any associated costs, and would again likely to paid a dividend (limited to a share of the prescribed part) between 18 months to 2 years after the date of administration;

iii) the most likely outcome for General Property Creditors would, in each case, be an unsecured claim in administration limited in the same way as I have described above in relation to the Landlords.

200. I am satisfied that each dissenting class of Plan Creditor will be no worse off under the Plans than in the relevant alternative of administration. This is because, in each case, creditors will receive a better return under the Plans for the following main reasons.

201. In the case of Class B Landlords, this is because they will receive a higher rate of rent under the Plans than they are likely to negotiate on an assignment in administration. Thus, under the Plans, Class B Landlords are entitled to full contractual rent and service charges from the effective date (whereas, in the relevant alternative, they are only likely to recover somewhere between market rent and contractual rent from a new purchaser on their over-rented properties following a void period). Class B Landlords will also receive the Restructuring Plan Return (which, it will be recalled, is calculated as 120% of the estimated dividend that would be paid in administration for their unsecured claim against the relevant Plan Company) in respect of their arrears, which will be paid sooner than any dividend in administration.

202. In the case of Class C Landlords, the outcome will also be better under the Plans. This is because, assuming they do not exercise their break right, they will receive 50% of the contractual rent for a period of up to three years, followed by full contractual rent for the remainder of the Lease. I accept the evidence of the Plan Companies that this is likely to result in a far better return over the life of the Lease than in the relevant alternative and, indeed, than if the break right is exercised – Mr Nicholson provided a helpful illustrative example of this in his evidence. If any Class C Landlord does exercise its break right, it will be entitled to a payment of 30 days' contractual rent, a sum which will be considerably more than the dividend it would receive in the relevant alternative of administration (and paid far earlier).

203. The same holds true for Class D Landlords: they will have a rolling break right from the effective date of the Plans which, should they exercise it within six months, will entitle them to a payment of 30 days' contractual rent. In nearly all cases, that payment will materially exceed 120% of the estimated administration return, a conclusion again usefully illustrated in the evidence of Mr Nicholson. If the rental payment does not provide a return of at least 120%, it will be topped up by the Plan Companies. Moreover, the payment of 30 days' contractual rent will take place earlier than the payment of a dividend in the relevant alternative. If any Class D Landlord does not exercise its break right, it will receive a Restructuring Plan Return (which is again a better outcome than a dividend in administration, both in terms of value and timing).

204. Class E Landlords also have a rolling break right from the effective date of the Plans, such that they can elect to re-let their site. As with Class D Landlords, they will also receive a Restructuring Plan Return which, for the same reasons, offers a better outcome than a dividend in the relevant alternative.

205. For General Property Creditors, the outcome under the Plans is also better, again due to the receipt of the Restructuring Plan Return.

206. Finally, I note that the calculation of the Restructuring Plan Returns owed to each creditor takes into account the returns that might be achieved in the relevant alternative

of administration by any creditor holding an upstream guarantee, such that any creditors falling within that group will also be no worse off under the Plans.

Conclusion on Issue 1

207. For the foregoing reasons, I am satisfied on the evidence before me that the most likely alternative to the Plans is an administration which would be conducted in the manner suggested by Deloitte in the Relevant Alternative Report (i.e. Scenario 1). I am also satisfied that none of the members of any of the dissenting classes would be any worse off under the Plans than in that relevant alternative. Accordingly, Condition A in section 901G(3) is met in relation to each Plan.

K. Issue 2: should the Court exercise its discretion to sanction the Plans?

The general approach to the exercise of discretion

208. The approach to the exercise of discretion under section 901G was considered by Trower J in DeepOcean, which was the first case to come before the courts in which that power fell to be exercised.

209. In DeepOcean, Part 26A plans were proposed in relation to a sub-group of three companies in a larger group involved in the provision of sub-sea services. The sub-group had underperformed for years and had required continued funding from the larger group. The plans were part of a wider refinancing of the whole group under which the ultimate owner of the group would inject $15 million by way of equity and subordinated debt into the group and the secured creditors would agree to an amended and restated facilities agreement for the wider group. The plan companies would, however, in effect be wound down. Under the plans, the secured creditors would release all their security and waive their claims against the plan companies. The plans also envisaged that all of the unsecured creditors of the plan companies would release their claims in return for payment of a small dividend of between 4% and 8% of the amount of their claims against the plan companies. This was to be funded by the wider group. The landlords of premises and owners of vessels used by the plan companies would also be able to retake possession of their properties and ships.

210. The relevant alternative to the plans was found by Trower J to be a scenario in which the wider group would refuse to continue supporting the plan companies, which would therefore be forced into administration or liquidation and/or undergo enforcement action by the secured creditors. In that event, the evidence provided by way of valuation reports from Alvarez & Marsal suggested that the secured creditors would receive a small recovery on their debt, but the unsecured creditors would recover nothing at all or only a nominal amount.

211. The plans were approved either unanimously or by an overwhelming majority in all classes of secured creditors and unsecured creditors for two of the three companies. In relation to the third company, the plan was approved unanimously by the secured creditors, but only received the approval of about 65% in value of the unsecured creditors who voted at the meeting, thus failing to achieve the 75% statutory majority required by section 901F.

212. After having referred to David Richards J's authoritative statement of the approach to sanction of a Part 26 scheme in re Telewest Communications No.2 [2005] BCC 36 ("Telewest") and my summary and application of it to a Part 26A plan in Virgin Atlantic Airways [2020] EWHC 2376 (Ch) ("Virgin Atlantic"), in which recourse to section 901G was not necessary because all of the classes had approved the plan by the requisite majorities, Trower J considered how to approach the exercise of discretion under section 901G.

213. Trower J first noted, at paragraph [44], that the statute gives little guidance on the factors that are relevant when the court is exercising its discretion to sanction a restructuring plan. I agree. Section 901G contains no express test or identification of any factors that should be taken into account, and leaves matters entirely at large.

214. Trower J then explained that the court should not have the same reluctance to differ from the vote at a class meeting when considering whether to exercise the power to cram down as it would have when considering whether to sanction a scheme under Part 26. Again, I agree. Under Part 26, the fact that the court is considering whether to sanction a scheme presupposes that the majority in each class has voted in favour of the scheme, and the issue is whether the court should nevertheless differ from the will of the majority and refuse to sanction it. Under Part 26A, the use of the cram-down presupposes that a class has either failed to approve the plan by the necessary majority (as in DeepOcean) or contains a majority which has positively expressed disapproval by voting against the plan (as in the instant case). As Trower J pointed out, by its very nature, the power to be exercised under section 901G contemplates that the court can override the wishes of a class meeting, even if 100% of the class has voted against the plan.

215. Trower J then referred to the Explanatory Notes prepared by the Department for Business, Energy and Industrial Strategy in relation to the introduction of Part 26A. These Explanatory Notes are admissible as an aid to the interpretation without needing to show that the legislation is ambiguous or unclear: see Flora v Wakom (Heathrow) Ltd [2007] 1 WLR 482 at [15]-[16]. The overview in the Explanatory Notes describes the basic purpose of Part 26A and its key features as follows,

> "9. [Part 26A] will allow struggling companies, or their creditors or members, to propose a new restructuring plan between the company and creditors and members. The measures will introduce a "cross-class cram down" feature that will allow dissenting classes of creditors or members to be bound to a restructuring plan. This means that classes of creditors or members who vote against a proposal, but who would be no worse off under the restructuring plan than they would be in the most likely outcome were the restructuring plan not to be agreed cannot prevent it from proceeding.
>
> ...
>
> 15. The new restructuring plan procedure is intended to broadly follow the process for approving a scheme of arrangement (approval by creditors and sanction by the court), but it will additionally include the ability for the applicant to bind

> classes of creditors (and, if appropriate, members) to a restructuring plan, even where not all classes have voted in favour of it (known as cross-class cram down). Cross-class cram down must be sanctioned by the court and will be subject to meeting certain conditions. 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….
>
> 16. While there are some differences between the new Part 26A and existing Part 26 (for example the ability to bind dissenting classes of creditors and members), the overall commonality between the two Parts is expected to enable the courts to draw on the existing body of Part 26 case law where appropriate."

216. The same concepts are repeated later in the same document,

> "190. Section 901F says that if 75% or more in value of creditors (or class of creditors) … present and voting either in person or by proxy at the meeting agreed to a restructuring plan, then an application may be made to the court to sanction the plan. 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."
>
> …
>
> 192. …As with section 901F, the court will still have an absolute discretion whether or not to sanction a restructuring plan, and may refuse sanction on the grounds that it would not be just and equitable to do so, even if the conditions in section 901G have been met."

217. In DeepOcean, at [48], Trower J considered that the Explanatory Notes,

> "48. … indicate that an applicant company will have a fair wind behind it if it seeks an order sanctioning a restructuring plan notwithstanding a dissenting class where the section 901G conditions A and B are met. Paragraph 192 [of the Explanatory Notes] is drafted in a way which suggests 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 restructuring plan is not just and equitable. The draftsman's focus was not on the more positive question of why justice and equity point to the plan being sanctioned.

> 49. On one view this is a small distinction, not least because no court will sanction a plan which it does not consider to be just and equitable. However, I think it reflects a recognition that, all other things being equal, satisfaction of conditions A and B is capable of justifying an override of the views of a dissenting class. This is not surprising in light of the fact that the court must have been satisfied already (a) that the purpose of the plan is to eliminate, reduce or prevent or mitigate the effect of financial difficulties that are affecting or may affect a company's ability to carry on business as a going concern (section 901A) and (b) that members of that class will be no worse off than they would be in the relevant alternative (section 901G(3)). So, to that extent their rights will have been varied by the plan in a manner which, objectively speaking, can only be neutral or better for them in its impact."

218. The parties in the instant case initially suggested that this was to be taken as an indication that the test to be applied under section 901G was that, provided that conditions A and B were satisfied, the plans should be sanctioned unless the court thought that the plans were not just and equitable. I do not consider that is what Trower J decided, or that such an approach would be correct.

219. The words "just and equitable" do not appear in section 901G, and they should not be read into it. I say that because, if posed as a question, "Would the court sanction a plan that it did not consider to be just and equitable?", as Trower J pointed out, the answer is obvious: it would not. But without a frame of reference by which to assess what is (or is not) just and equitable, such a test would be meaningless and would not carry matters any further forward.

220. It is also the case that, contrary to the suggestion in paragraphs 15 and 190 of the Explanatory Notes, there has never been such a test in relation to the exercise of discretion under Part 26 in relation to schemes of arrangement. The expression "just and equitable" does not feature in Part 26 or as a part of the approach outlined by David Richards J in Telewest.

221. Although David Richards J indicated, at paragraph [21], that the court must be satisfied that a scheme under Part 26 is a "fair" scheme, he explained that this did not mean that the court applied its own test of what it thought was fair. Rather, it applied a test of rationality to what, *ex hypothesi*, would be an affirmative majority vote in favour of the scheme, namely,

> "It must be a scheme that 'an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve'. That test also makes clear that the scheme proposed need not be the only fair scheme or even, in the court's view, the best scheme. Necessarily there may be reasonable differences of view on these issues."

In my judgment, there is no more justification under Part 26A than in relation to Part 26 for the court simply to impose its own views of what is (or is not) "fair" or "just and equitable".

222. Further, and for the reasons set out above, whilst a rationality test can be applied when considering whether to sanction a scheme under Part 26 which has been approved by a majority in each relevant class, the same test cannot necessarily be applied in the same way when the court is considering whether to exercise the power under section 901G to sanction a Part 26A plan against the views expressed by a dissenting class.

223. Although Mr. Smith QC sought to persuade me to do so, I also consider that one should be careful not to read too much into Trower J's comments (i) that a plan company that satisfies Conditions A and B in section 901G "will have a fair wind behind it", and (ii) that "all other things being equal, satisfaction of conditions A and B is capable of justifying an override of the views of a dissenting class". Trower J expressed these views in cautious terms – i.e., a "fair wind" and "capable" of justifying, and he added the important caveat of "all other things being equal". He was certainly not saying that satisfaction of Conditions A and B would, of themselves, be sufficient in all cases.

224. Nor do I consider that Trower J was intending to suggest that because Conditions A and B were met, that the court should presume that the plan should be sanctioned and that it would not need to consider all the other relevant factors and circumstances that it would ordinarily take into account. I say that because even in a case in which all classes have voted in favour of a scheme or plan, the court will still check that all creditors are likely to do better under the scheme or plan than under the likely counterfactual comparator (because otherwise the majority would not have been voting rationally) and will also follow (with appropriate modifications in the case of a plan) the remainder of the approach outlined in Telewest. The approach cannot be any less rigorous because one class has voted against a plan than where all classes have voted in favour.

225. Indeed, in DeepOcean, Trower J went on to consider a series of other factors relevant to the exercise of his discretion, taking the approach in Telewest as his starting point. Thus, for example, he considered whether the affirmative votes in the assenting classes were representative of the class and whether they might have been voting in favour of the plans for some collateral purpose. Trower J also considered the overwhelming support for the plans generally. In particular, he noted that the two classes of unsecured creditors who were in a similar position in relation to the two other plan companies to the class of creditors which had just failed to achieve the necessary 75% majority in relation to the third company, had both voted in favour of the plans. This meant that he was able to conclude that an intelligent and honest man in the class that had failed to achieve the required majority could rationally have voted in favour of the plans.

Out of the money creditors

226. In DeepOcean, Trower J also considered two related issues that dominated the debate in the instant case, namely the approach to the treatment of creditors who are "out of the money", and the question of the distribution of the benefits of the restructuring (what some commentators have called the "restructuring surplus").

227. Trower J commenced his analysis by reference to a line of scheme cases under Part 26 including, in particular, MyTravel Group plc [2005] 1 WLR 2365 ("MyTravel") [2010] BCC 209. In those cases, schemes were sanctioned which provided for junior creditors who would be out of the money in a formal insolvency to be excluded from participation

in a scheme because they had no economic interest in the company. Trower J continued,

> "51. One aspect of this incremental development is that Part 26A has introduced an ability to bind a dissenting class where they have an economic interest in the company and are not therefore out of the money in the relevant alternative. However, where the evidence is that the members of the dissenting class are out of the money in the relevant alternative, and that their exclusion would in any event have been achievable if a Part 26 scheme had been proposed, it seems to me that their receipt of any benefits under the terms of the proposed Restructuring Plan means that they are unlikely to have been treated in a manner that is not just and equitable. Indeed, in such a case, section 901C(4) means that it may not have been necessary for such creditors to be summoned to a class meeting in the first place.
>
> 52. In the present case, the benefits to be received under the terms of the Restructuring Plan by all of the Other Plan Creditors (including in particular the members of the DSC Other Plan Creditor dissenting class) are to be provided by DeepOcean group entities other than the Plan Companies. This factor, combined with the fact that the DSC Other Plan Creditors are out of the money in the relevant alternative is in my view a powerful pointer towards sanctioning the Restructuring Plan by use of the power under section 901G."

228. Trower J then returned to this theme at paragraphs [62]-[65],

> "62. The next discretionary factor that may apply in section 901G cases relates to the relative treatment of creditors under the proposals and has much in common with what has come to be called the "horizontal comparison" that the court will often carry out when considering an unfair challenge to a company voluntary arrangement. It is the second of the two heuristics referred to by Norris J in the Debenhams case at [12] … It compares the treatment of creditors under the CVA inter se. As Norris J said: "whilst there is no prohibition on differential treatment, any differential treatment must be justified".
>
> 63. In my 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 in the context of a cross-class cram down to see whether a restructuring plan provides for differences in treatment of creditors inter se, and if so whether those differences are 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 restructuring plan and those who have not.

> 64. In the present case, the difference in treatment of DSC Secured Creditors and DSC Other Plan Creditors is obvious, but it is plain that differential treatment is justified because of the secured nature of the DSC Secured Creditor claims. Furthermore, it seems to me that the fact that the DSC Other Plan Creditors were out of the money in the event of the relevant alternative, and that the benefits they receive from the Restructuring Plan are derived from sources other than DSC, means that a horizontal comparison is of much less significance than might otherwise be the case. There are no assets from which they would derive benefit in the absence of the Restructuring Plan and it is difficult to identify any legal basis on which they can complain about the choice made by the other members of the DeepOcean group to apportion the contribution they make to the Restructuring Plan in such manner as they see fit.
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> 65. The other category of DSC creditors who have been treated differently from the DSC Other Plan Creditors are DSC's excluded creditors. I explained the reasons for their exclusion in the convening judgment and why it was that I was satisfied that the Plan Companies had good commercial reasons for taking that course."

229. These observations were relied upon by Mr Smith QC for the Plan Companies as the basis of a submission that if I had reached the conclusion that the relevant alternative was an administration in which the unsecured creditors would be out of the money (save for the prescribed part) then I should exercise the power to sanction the plan under section 901G, because it could not be unjust or inequitable for the dissenting classes of Landlords and General Property Creditors to receive 120% of those estimated returns.

230. Further, so he submitted, because the dissenting classes of Landlords and General Property Creditors would be out of the money in the relevant alternative, they had no rights to any assets of the Plan Companies from which they could derive any benefit in the absence of the Plans. Thus, he argued, they could have no basis to complain about the willingness of the Secured Creditors (who would derive sole benefit from the assets of the Plan Companies in the relevant alternative) to approve Plans under which, in return for the provision of new money, the Shareholders would obtain potential benefits from the restructuring by the retention of their shares in the Plan Companies, and the restoration and any future increase in the value of those shares.

231. In considering those submissions, it is important to appreciate that, on the facts of DeepOcean, the plan companies were being run down and were not going to continue trading. There was, therefore, no prospect of any "restructuring surplus" arising for shareholders by reason of the restoration of value to the shares in the plan companies. Hence Trower J's analysis was limited to the question of the manner in which the plans provided for the division of the assets of the plan companies and the contribution to those assets that was going to be made by the remaining members of the wider group.

232. In that respect, Trower J made the obvious point that the unsecured creditors could not complain about the priority given to the secured creditors to the assets of the plan companies. Nor, he held, could the unsecured creditors complain about the division of

the contribution to be made by the shareholders which the unsecured creditors would have had no right to receive in the relevant alternative, but which, under the Plans, would be used to pay them more than they would receive in that relevant alternative.

233. Given those facts, it is apparent that in DeepOcean, Trower J did not have to address directly the arguments now being made by the AHG Landlords in the instant case. The key factual difference between the two cases is that the Plans in the instant case are designed, by the reduction of existing unsecured debt and the provision of new money, to enable the Plan Companies to continue in existence and to trade again profitably. This carries with it the possibility (the AHG Landlords say the probability) that the shares in the Plan Companies will increase in value from future trading, thereby potentially benefitting the Shareholders (possibly substantially).

234. The AHG Landlords point out that in the relevant alternative of an administration, the Shareholders would rank behind the unsecured creditors and their shares would be entirely worthless. The AHG Landlords contend that it would be contrary to basic principles of insolvency law that any benefits from implementation of the Plans in terms of the restoration or enhancement in value of the shares in the Plan Companies (the so-called restructuring surplus) should be enjoyed entirely by the existing Shareholders to the exclusion of the (prior ranking) unsecured creditors who they contend have contributed to the survival of the Plan Companies by the release of their present and future claims under the Plans.

235. The AHG Landlords contended that a "fair" or "just and equitable" division of the restructuring surplus would require the allocation of a substantial part of the equity of the Plan Companies to the Landlords (and other unsecured creditors), but that this was (wrongly) simply never considered in the formulation of the Plans, which were negotiated between the Plan Companies, the Secured Creditors and the Shareholders.

236. The AHG Landlords also contended that the favourable treatment of the existing Shareholders cannot be justified solely by their provision of new money under the Plans but even if it could, it is unjust that the members of the AHG Landlords (and other unsecured creditors) were not offered an equal opportunity to participate in the provision of such new money.

237. In addressing these submissions in the instant case, it is first necessary to identify the insolvency process in which considerations of the "relative priority between creditors and shareholders" would arise. In the instant case, as I have found, the comparator or relevant alternative to the Plans is a (trading) administration in which the assets of the Plan Companies would be realised by the administrators and the proceeds then distributed among the creditors in accordance with the priorities set out in the Insolvency Act 1986.

238. As Trower J explained in DeepOcean, the conventional approach of the English courts to scheme cases under Part 26 in which such a situation has arisen goes back to Re Tea Corporation Limited [1904] 1 Ch 12, and it can be traced through other cases such as Oceanic Steam Navigation Company [1939] Ch 41 and more recent cases such as MyTravel and Bluebrook. In each of those cases, the essence of the proposal was that the business and assets of the failed company should be transferred to a new company to be owned by those who would have been entitled to share in the distribution of the proceeds of sale of those assets in a formal insolvency. By this route, the creditors and

shareholders who would be out of the money in the formal insolvency would be left behind in the shell of the old company, and the benefits of future trading would be enjoyed by those who would be in the money in the formal insolvency.

239. The approach was summarised by Mann J in Bluebrook at paragraph 25 as follows,

> "…in promoting and entering into a scheme, it is not necessary for the company to consult any class of creditors (or contributories) who are not affected, either because their rights are untouched or because they have no economic interest in the company. This is apparent from Tea Corporation [1904] 1 Ch 12, where the Court of Appeal held that the dissent of ordinary shareholders would not stop a scheme being sanctioned, because although those shareholders had a technical interest as shareholders, they in fact had no economic interest in the company because the assets were insufficient to generate a return to them in the liquidation that was then on foot. As Vaughan Williams LJ said (at page 23):
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>> "It would be very unfortunate if a different view had to be taken, for if there were ordinary shareholders who had really no interest in the company's assets, and a scheme had been approved by the creditors, and all those were really interested in the assets, the ordinary shareholders would be able to say that it should not be carried into effect unless some terms were made with them."
>
> If there is a dispute about this, then the court is entitled to ascertain whether a purported class actually has an economic interest in a real, as opposed to a theoretical or merely fanciful, sense, and act accordingly - see the reasoning in Re MyTravel Group plc [2005] 2 BCLC 123 at first instance. Where things have to be proved, the normal civil standard applies. The same case indicates that the mere fact that the possibility of establishing a negotiating position and extracting a benefit from a deal is not the same as having a real economic interest (though obversely a real economic interest may establish, or enhance, a negotiating position). The basis on which the assessment of that interest is to be carried out will vary from case to case."

240. A more recent illustration of this principle is Re Noble Group Limited (sanction) [2019] BCC 349 ("Noble Group"). In that case, the holders of a class of subordinated debt (the "perpetual capital securities") were not included in the definition of scheme creditors whose claims were to be compromised by the scheme. That had the consequence that those creditors were not entitled to vote on the scheme and would be left behind as unsatisfied creditors of the company when the business and assets of the company were transferred to newly formed subsidiaries of a new holding company pursuant to the scheme. That new holding company was to be 70% owned by the unsecured creditors who would be entitled to a return in a liquidation of the scheme company, 20% by the existing shareholders of the scheme company, and 10% by the existing management.

241. A lawyer for the holder of perpetual capital securities had written to the company objecting that this arrangement undervalued the interests of the perpetual capital securities in the scheme company. Although that creditor did not appear at the sanction hearing to challenge the scheme, Mr. Trower QC (as he then was) very properly drew my attention to it. I dealt with it by first noting that there could be no sensible challenge to the scheme company's assessment that its very large balance sheet deficiency meant that the holders of the perpetual capital securities were substantially "out of the money". I then also considered whether any doubt was cast upon the scheme by the fact that the shareholders of the scheme company (who would rank below the holders of the securities in a formal insolvency) were to receive 20% of the equity of the new holding company, and the management of the scheme company (who would not, as such, rank in a formal insolvency at all) were to receive 10% of the equity of the new holding company. I stated,

> "86. The answer to that point was, however, given by Mr Trower QC. He submitted, and I accept, that on the evidence, it is clear that the value in the company and in the business of the Group in essence belongs to the unsecured creditors, i.e. the scheme creditors, together with those who have reached bilateral arrangements with the company or whose debts will be paid in the ordinary course, and who have therefore been excluded from the scheme. Mr Trower QC submitted that it is up to the scheme creditors to determine how to divide that value up between them in the restructuring. They have done so and have decided that they will, for commercial reasons, share some of the value with the company's existing shareholders and management."

242. That established approach in relation to scheme cases reflects the view that where the only alternative to a scheme is a formal insolvency in which the business and assets of the debtor company would be held on the statutory trusts for realisation and distribution to creditors, that business and assets in essence belongs to those creditors who would receive a distribution in the formal insolvency. The authorities take the view that it is for those creditors who are in the money to determine how to divide up any value or potential future benefits which use of such business and assets might generate following the restructuring (the restructuring surplus).

243. These principles were plainly understood when Part 26A was introduced into the Companies Act 2006 in the midst of the pandemic in 2020. Earlier consultation papers on the possible introduction of a new restructuring tool with cross-class cram down capabilities had expressly addressed the issue of the appropriate comparator for use in relation to cross-class cram down and position of creditors who would be out of the money.

244. So, for example, in paragraph 5.148 of the *Government's Response to its 2016 Review of the Corporate Insolvency Framework*, published on 26 August 2018 under the heading "*Insolvency and Corporate Governance*", the Government stated,

> "The Government agrees with the majority of respondents that a procedure that allows for the cross-class cram down of dissenting classes of creditors, subject to safeguards, would be a useful addition to the UK's business rescue tools. The

> introduction of such provisions will help the UK maintain its position as a leading global restructuring hub. *The restructuring plan will represent a streamlined procedure in which dissenting classes of creditors, most importantly those who are 'out-of-the-money' (i.e. those who, under the order of priority for creditor repayment in administration or liquidation, would not receive any dividend), may be bound to an arrangement that is in the best interests of all stakeholders.* The Government also agrees with those respondents who opined that the existence of such a procedure may well encourage more consensual restructurings."
>
> (my emphasis)

245. Thereafter, in paragraphs 5.169 to 5.176 of the same document, the Government expressly rejected earlier suggestions that cross-class cram down should be permitted and its fairness assessed against a minimum liquidation valuation, preferring instead a "next best alternative to the restructuring plan". The response noted, at paragraph 5.173,

> "As many pointed out, administration would typically be a more likely alternative result were a restructuring plan to be rejected. This is because a restructuring plan would probably only be considered if a business was viable. If a business is viable, administration is a more likely insolvency destination than liquidation if a restructuring plan is not approved. Creditors could be justified in expecting a higher level of return in administration rather than liquidation, so might challenge a valuation based on liquidation value."

246. A similar explanation was given at page 29 of *The House of Commons Briefing Paper (CBP8291) Corporate Insolvency Framework: proposed major reforms*, published on December 2019,

> "In determining whether a plan which effects a cram down of dissenting classes is fair, the test will be whether the plan gives a better outcome to creditors than the next best alternative. This may not necessarily be liquidation (e.g. administration may be a realistic option and deliver a higher value than liquidation). Ultimately, it will be for the court to determine what the next best alternative for creditors is."

247. Against that background, there is nothing in the provisions finally enacted as Part 26A, or in the Explanatory Notes, that indicates that the legislature intended any different approach to be adopted by the court to the position of creditors who are out of the money under the relevant alternative. Quite the reverse: the provisions of Part 26A build upon that approach. Although section 901C(3) provides that every creditor whose rights are affected by a plan must be permitted to participate in a class meeting, section 901C(4) provides that this does not apply to a class of creditors if the court is satisfied that no member of that class "has a genuine economic interest in the company". It is, I consider, tolerably clear that this test of a "genuine economic interest" reflects the observations of Mann J in Bluebrook that what the court must ascertain is whether a

purported class "actually has an economic interest in a real, as opposed to a theoretical or merely fanciful, sense", and that it is to be applied to the plan company by reference to the relevant alternative for the company if the plan is not sanctioned.

248. That conclusion is, to my mind, put beyond doubt by paragraph 188 of the Explanatory Notes to Part 26A that explains that as a default under section 901C(3), all creditors whose rights are to be affected by the compromise or arrangement must be permitted to participate in the class meetings, but then states,

> "However, if the court is satisfied that a class of creditors or members has *no genuine economic interest in the company (an 'out of the money' class)*, the court may order for that class of creditors or members to be excluded from the meeting summoned in subsection (1)."
>
> (my emphasis)

249. The express equation of creditors with "no genuine economic interest in the company" with an "out of the money class" is striking. The logic of this point is that if creditors who would be out of the money in the relevant alternative could be bound to a plan which effects a compromise or arrangement of their claims without even being given the opportunity to vote at a class meeting, the fact that they have participated in a meeting which votes against the plan should not weigh heavily or at all in the decision of the court as to whether to exercise the power to sanction the plan and cram them down. Nor is it easy to see on what basis they could complain that the plan was "unfair" or "not just and equitable" to them and should not be sanctioned. That point was made expressly by Trower J at the end of paragraph 51 of his judgment in DeepOcean.

250. Mr. Dicker QC sought to counter these conclusions by giving an example in argument, which he suggested illustrated why satisfaction of the "no worse off" requirement in Condition A of section 901G could not be the "last word on the subject", and that there needed to be what he described as a "robust" approach by the court to the exercise of discretion under Section 901G.

251. Mr. Dicker QC postulated a company whose business relied on a form of regulatory licence that would be terminated in the event of insolvency, which would render the company unable to trade and its business valueless. Assume that the company encountered financial difficulties sufficient to pass the test in section 901A, and then identified two classes of contracts which it had with unsecured creditors, some profitable and some unprofitable. The company then proposed a Part 26A plan under which the former class of creditors were essentially promised payment in full (albeit with some minor changes sufficient to constitute a compromise or an arrangement): but the plan provided for the effective termination of the unprofitable contracts of the latter class of creditors for only a little more than those creditors would get in the relevant alternative – which, because of the loss of the regulatory licence, would be next to nothing. On the assumption that the former class would vote in favour of the plan and the second would vote against, Mr. Dicker QC posed the question whether the court would exercise the power of cram down, with (as he put it) the result that the company would have resolved its financial difficulties primarily at the expense of the class of creditors who had the unprofitable contracts, and with the shareholders effectively continuing to enjoy the value of their equity?

252. There are, I think, a number of answers to the points raised by Mr. Dicker QC's example. The main ones are that it does not address the point that Mr. Smith QC was making, and nor does it correspond in certain important respects to the facts of the instant case.

253. Mr. Dicker QC's example essentially raised the question of discrimination between creditors who would be in the money and who would rank equally in the relevant alternative, and all of whom would, in that scenario, be entitled to share in the value of the business and assets of the company to the same extent. It also postulated a company that, because of loss of its regulatory licence, would not be able to enter a trading administration to preserve its business, but would essentially be liquidated if the plan did not go through. In Mr. Dicker QC's example, the valuation of the business and the return to the dissenting creditors in the relevant alternative would not capture the enterprise value of the company that would be preserved by the sanction of the plan. In such a case I see that it might well be argued that satisfaction of the "no worse off" test in respect of the dissenting class would not, of itself, appropriately reflect the interest of the dissenting class in the company and its business, and that the plan should not be sanctioned because it would effectively transfer value from the dissenting class to the other creditors and the shareholders.

254. The main point of distinction, however, is that in the instant case the value "breaks" in the class of Secured Creditors who, by reason of their security, would therefore be entitled to all of the value of the business of the Plan Companies (including the enterprise value), in the relevant alternative, to the exclusion of the Class B-E Landlords and the General Property Creditors, who would not be entitled to any of that value (save as to the prescribed part).

255. Mr. Dicker QC's example would have been more relevant if there had been no Secured Creditors in the instant case and the battle on sanction had been between the A Lease Landlords as the assenting class and the remaining classes of B-E Lease Landlords and General Property Creditors as dissenting classes, and that each of those classes would have been in the money in the relevant alternative. In such a situation the court might well have to look closely at whether the proposed compromise with the assenting class was a real compromise or arrangement of their rights, or a manipulation of the classes; and it would also have to look closely at whether the dissenting class received a share of the value of the enterprise that was preserved by the plan that was in some way proportionate or comparable to the compromise that they were being asked to make. That is not, however, the instant case.

256. The analysis that I have set out above appears to me to be consistent with the views expressed by Professor Riz Mokal in his two articles on Part 26A in Butterworths Journal of International Banking and Financial Law in December 2020 ("*The two conditions for the Part 26A cram down*") and January 2021 ("*The court's discretion in relation to the Part 26A cram down*"). In the January 2021 article, after identifying the concept of a restructuring surplus, Professor Mokal suggests that the fundamental (but not only) purpose of judicial discretion as to whether to approve a cram down is to assess whether the proportion of the restructuring surplus allocated to a dissenting class is "just and equitable" (or in the language of Chapter 11 of the US Bankruptcy Code, "fair and equitable").

257. Professor Mokal makes it clear, however, that this principle of allocation of the restructuring surplus is only applicable as between the creditors who have a genuine economic interest in the company, and have not either been excluded from voting at all under section 901C(4), or have had their votes effectively discounted at sanction on the same basis. He then continues,

> "Consider the situation in which each of three conditions is met: (i) the plan affects the rights of the members of a class in which the plan has not received the requisite support and the court was not persuaded either to; (ii) exclude the class from the meeting; or to (iii) discount the votes of its members, in each case on the basis that such members lacked a genuine economic interest in the company. It appears to me to follow ineluctably that the creation of any restructuring surplus depends, at least *pro tanto*, on affecting the rights of the members of the dissenting class. It follows in turn that such members are entitled to a "just and equitable" (or, if you prefer, a "fair and equitable") share of the surplus to reflect the imposition upon them of some of the costs incurred in order to create the surplus."

258. As I read it, in that analysis, Professor Mokal asks whether the share of the restructuring surplus allocated to the dissenting class appropriately reflects the imposition upon them of the costs incurred by the alteration of rights under the plan to create that surplus. *Ex hypothesi*, a creditor who is out of the money has a worthless debt, and the alteration of rights under the plan can impose no further costs upon him.

The horizontal comparison in plan cases

259. Although the key principle therefore appears to be that both under Part 26 schemes and Part 26A plans it is for the company and the creditors who are in the money to decide, as against a dissenting class that is out of the money, how the value of the business and assets of the company should be divided, the question remains whether there are any limitations upon how the plan company can confer benefits upon other creditors. Can, for example, the power under section 901G to cram down a dissenting class of out of the money creditors be exercised in relation to a plan under which some value is given to other selected creditors who would also be out of the money, or to other persons who are not creditors at all (e.g. shareholders)? And if so, are there any limits to how that can be done? In essence this raises the question of horizontal comparison in plan cases.

260. The answer to the question 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 was answered in the affirmative in DeepOcean. As Trower J explained in the convening judgment ([2020] EWHC 3549 (Ch)) at paragraphs [11]-[12], the plans excluded altogether a series of unsecured commercial creditors who would have been out of the money in the relevant alternative, but who were to be paid in full prior to the implementation of the plans, together with employees and tax creditors who were to be paid by the other members of the group. In his judgment sanctioning the plans, Trower J briefly observed, at paragraph [65], that although there had been a complaint about the way in which the plan companies had gone about

selecting such excluded creditors, he was satisfied on the evidence that there were "good commercial reasons" for taking that course.

261. In relying on such justification, Trower J was reflecting the approach frequently taken in scheme cases under Part 26 to unsecured creditors such as critical suppliers, trade creditors and employees, who are often excluded from schemes on the basis that it would be commercially impracticable or undesirable to require them to accept a compromise of their claims: see e.g. SEA Assets Ltd v PT Garuda Indonesia [2001] EWCA Civ 1696.

262. I took a similar approach to such creditors under Part 26A in Virgin Atlantic, albeit that the point was not contentious, because the exclusion of various groups of creditors in that case had been properly explained in the explanatory statement, all classes of creditors included in the plan had voted in favour, and I was not required to exercise the power under section 901G.

263. So far as conferring benefits on shareholders is concerned, in Noble Group I accepted the proposition that the holders of the subordinated perpetual capital securities, being out of the money, had no basis to complain that equity in the new holding company was to be given to shareholders and directors of the scheme company (see above). However, I also referred, at paragraphs [87]-[88], to the fact that there were credible commercial reasons offered by the scheme companies for these decisions. Giving equity in the new holding company to the old shareholders was explained on the basis that the restructuring required the approval of the shareholders to the transfer of assets from the scheme company, and that came at a price. Giving equity to the directors was justified because in the money creditors wished to ensure that the existing management were retained (and incentivised) to run the business after transfer to the new holding company, thereby retaining the benefits of their relationships with key customers and suppliers (a benefit sometimes referred to inelegantly as "sweat equity").

264. In the instant case, the issue of unequal treatment potentially arises first in relation to the Class A Landlords and the Excluded Creditors. The evidence is that the directors of the Plan Companies have exercised their commercial judgment, with the agreement of the Secured Creditors, that it was necessary, in order to preserve the businesses of the Plan Companies, to ensure the retention of the Class A Leases which are the Leases in respect of the most profitable clubs that are essential to the future of the businesses. It was also considered necessary, in order to ensure the retention and goodwill of the employees, that the trade creditors and the other categories of Excluded Creditors should be paid in full. Those decisions and the commercial judgment which underpinned them was not challenged by the AHG Landlords and it was not suggested that such matters could justify refusing to sanction the Plans.

265. Nor did the AHG Landlords challenge the differing treatment accorded to each of the classes of Class B-E Landlords and the General Property Creditors. That differential treatment was explained by reference to the profitability and commercial importance that the Plan Companies attached to the clubs operating from the properties subject to the different Leases and to the desire of the Plan Companies to eliminate contingent liabilities arising in connection with those Leases and other historical leases. There may, in principle, be reasons for the Court to decline to exercise its discretion to sanction a plan that discriminated arbitrarily or capriciously between different classes

of unsecured creditors who were all equally out of the money, but I do not need to explore the boundaries of any such principle on the facts of this case.

266. Instead, as indicated above, the AHG Landlords objected to what they see as the favourable treatment given to the Shareholders, who will not have been required to surrender any of their equity in the Group and will therefore share in the potential restructuring surplus. I have, for the reasons that I have explained, found that since the AHG Landlords would be out of the money, their objections to what the Secured Creditors have agreed with the Plan Companies in this respect carry no weight.

267. It is therefore not necessary for me to explore in any detail the criteria that the court might have to use to determine whether it would have been appropriate for such benefits to be conferred on the Shareholders had this been at the expense of creditors who were in the money. Suffice to say, however, that if it had been necessary for me to reach a view on this issue, the following points would seem to me to be relevant.

268. First, to the extent that the Plans permit the Shareholders to retain part of the enterprise value of the restructured Plan Companies, the parties primarily affected by that are the Secured Creditors who would be in the money in the relevant alternative and who rank ahead of the unsecured Landlords and General Property Creditors. The Secured Creditors are independent and sophisticated financial entities who it appears on the evidence that I have seen acted in a commercially rational way in order to protect the value of the debts owed to them by the Plan Companies and their interests in the restructured Group.

269. Whatever might have been suggested as regards the approach to negotiations of the directors of the Plan Companies, there is no basis whatever in the evidence for a finding that the Secured Creditors have taken anything other than a commercially rational approach to the Plans. But if the Secured Creditors did not see fit to demand a stake in the equity of the restructured Group as a condition of agreeing to the Plans, it is not easy to see on what basis the Class B-E Landlords or the General Property Creditors who rank behind them could complain that they should have been given such a share in the equity instead.

270. Second, I summarised above certain criticisms advanced by Mr Dicker QC on behalf of the AHG Landlords to the effect that they had effectively been shut out of the negotiations over the terms of the Restructuring and the Plans. I concluded that this issue was not relevant to the question of identifying the relevant alternative, but that it might be relevant to the question of whether to exercise my discretion to sanction the Plans.

271. The evidence of Mr Nicholson was that it was appropriate to approach the Shareholders first because they were a major stakeholder with the greatest incentive to invest on favourable terms. Further, as Mr Bucknall described in his evidence, once the Plan Companies had identified the possibility of the Shareholders providing new funds, it was essential to seek the support of the Secured Creditors. This is because the Secured Creditors would need to provide waivers and consents under the Senior Facilities Agreement to enable new money to be advanced. On this basis, the order in which stakeholders were approached to agree the terms of the Restructuring and the Plans appears, on the evidence before me, to have been reasonable and appropriate in the circumstances.

272. In oral evidence, Mr Nicholson explained the approach taken to seeking a resolution of the Plan Companies' financial difficulties:

> "Looking at [the] UK business, in thinking about what concessions to look for [from] landlords, we were trying to work out how the four different parties contributed: shareholders … secured creditors … the licensor … and then the landlords. It was trying to work out the jigsaw of those four pieces but in doing that we then looked hard at the position of the landlords … Then colleagues of mine gave me a judgment based on their experience from CVAs as to what it would be appropriate to ask for and what could be deliverable."

273. Mr Nicholson rejected Mr Dicker QC's characterisation of that approach as being to seek from Landlords whatever the Shareholders and Secured Creditors were unwilling to provide:

> "Q. Essentially, having had the shareholders and the lenders indicating their views, what was left effectively needed to come from the landlords; is that fair?
>
> A. No, my Lord, I am afraid the sequence is slightly different to what counsel describes. We formed a view on the landlord piece, broadly concurrently with the other pieces. We formed a view and then we set about trying to go and secure that funding and those different contributions from the different parties … It is a sequence point, my Lord. It was not a question of I went and asked what the shareholders wanted and then the landlords became the bit at the end. We tried to work it out and then go and get those pieces."

274. The evidence of the Plan Companies reveals a further reason that the Landlords were not uppermost in the minds of the directors and their advisers when seeking a consensual resolution to the financial difficulties the Group faced. I have already summarised above the different approaches taken by landlords in different jurisdictions. In his evidence, Mr Bucknall observed that:

> "By the beginning of the second national lockdown in the UK on 5 November 2020, only one Landlord Creditor of a club operated by the Plan Companies had waived rent for any part of the closure period (except for rent concessions agreed with a number of landlords in conjunction with significant lease extensions) … By contrast, substantial compromises have been agreed with the vast majority of landlords of the Italy and APAC clubs. This is a result of, amongst other things, differing Government schemes in these regions, the terms of the leases themselves, and, related to these two features, the willingness of those landlords to come to consensual arrangements with the relevant Group companies".

275. In his oral evidence, Mr Bucknall also revealed a degree of frustration over his efforts to deal with Landlords. Asked by Mr Dicker QC whether Part 26A was identified as the appropriate route because alternative routes (such as CVAs) would have given the Landlords a stronger negotiating position, Mr Bucknall said,

> "[M]y experience [in] trying to do consensual deals [was] that it was not possible to get anywhere with the landlords, having spent a lot of time with them, and yes, a CVA was likely to result in a blocking from the landlords which would obviously mean they would be in a stronger position on the CVA not to come to a holistic solution."

276. On that latter point I do not consider that there was anything inappropriate in the Plan Companies choosing to utilise Part 26A rather than a CVA if that appeared more likely to achieve the desired result of rescuing the companies in the interest of their stakeholders generally.

277. Accordingly, I see no basis upon which the AHG Landlords can contend that the approach to negotiations adopted by the Plan Companies was, of itself, inappropriate or should lead me to decline to sanction the Plans.

278. Third, it is undoubtedly the case that the Shareholders have agreed to provide significant contributions by way of new money to finance the future operations of the Group. In essence the point made is that the Shareholders are paying an appropriate amount of new money for their retention of their equity. The Plan Companies also contend that the debts to be compromised by the Class B-E Landlords and the General Property Creditors under the Plans are not comparable to that new money.

279. The Plan Companies identified the new monies to be provided as consisting of £60.4 million to be advanced on an unsecured basis by the Shareholders or their affiliates comprising (i) new junior facilities totalling £45 million, (ii) the £6 million equity injection to finance the payments of the Relevant Alternative Return under the Plans, and (iii) the waiver of about £9.4 million of licence fees by VEL, which is a company ultimately owned and controlled by Sir Richard Branson.

280. The argument advanced by Mr. Mackenzie in his evidence, and by the AHG Landlords in their written submissions, was that the £60.4 million new monies to be provided by the Shareholders should be equated with the required write-offs of rent arrears and future rentals under the Plans by the Class B-E Landlords, which they quantified at about £41 million. Mr. Mackenzie and the AHG Landlords submitted that this should result in the Shareholders and the Class B-E Landlords sharing the equity of the Plan Companies after the restructuring in the ratio 59.6%:40.4% (calculated as (60.4/60.4+41): (41/60.4+41)). I do not accept that argument. Most of the two sets of payments are not comparable.

281. Although it was not a point specifically made by the AHG Landlords or Mr. Mackenzie, I can see that the waiver of the £9.4 million of future licence fees by VEL (which I assume will fall due under an existing contract) might be regarded as equivalent to the enforced reductions under the Plans of the future rentals payable to the Class B-E Landlords under their leases.

282. However, that is not so for the remainder of the payments to be made by the Shareholders. There is, in my judgment, a considerable difference between waiver of liabilities already contracted for and which would be worthless in a formal insolvency, and new monies which will, if the Plans are sanctioned, be made available to finance future operations and which will be at risk from those continuing operations.

283. The point was well put by Mr. Nicholson in cross-examination. He explained,

> "… as we sit here today, we are in an environment where the shareholders are [agreeing to provide] new funding into the business. If the business stopped tomorrow, they do not lose that money. Okay? It is genuinely new money that they [will be] putting into the business. If I look at the situation of the licensees or the landlords, what we are talking about is them not receiving in full what is a current obligation. If the business stopped today, then they would not get their rental streams or their licence streams from this corporate entity."

284. Moreover, even if (which I do not accept) the write-off under the Plans of the claims of the Class B-E Landlords could be characterised as contributing to the restructuring surplus, those write-offs would not stand alone. Under the Plans, the claims of the General Property Creditors are also to be compromised on the same terms and hence would qualify for similar treatment. So also would the unsecured claims of other companies in the VA Group under the control of the Shareholders which amount to £185 million and are to be waived as part of the wider restructuring. In cross-examination, Mr. Mackenzie could not explain why he had not included the waiver of such inter-company claims in his calculation of the share of the post-restructuring equity of the Plan Companies which he contended the Class B-E Landlords should obtain.

285. Mr. Dicker QC's primary objection to the provision of the £6 million to be injected by the Shareholders by way of equity to finance the payments of the Relevant Alternative Returns, and to the provision of £45 million of new liquidity to finance the operations of the Group after the Plans take effect was that the AHG Landlords had not been given the opportunity to participate in their provision, and that the new junior facility was not provided on market terms negotiated at arm's length.

286. In this respect, Mr. Dicker QC relied on scheme cases in which an opportunity to provide new money to a scheme company or to subscribe for additional equity shares in the restructured company, conditional upon sanction of the scheme (often called a "risk participation"), has either been available to some, but not all, scheme creditors; or even if the opportunity was made available to all, that it had not been taken up by all creditors. As well as giving rise to potential class issues at the convening stage, Mr. Dicker QC pointed out that such matters can also be relevant to the exercise of discretion by the Court at sanction if it is thought that those creditors who have availed themselves of the opportunity to "risk participate" may thereby have had an additional incentive to vote in favour of the scheme than others in their class. In such a case, it might be argued that if and to the extent that the majority vote at the class meeting comprised such creditors, it could not be regarded as being cast in the interest of, or that it was not representative of, the class as a whole: see e.g. Re New Look Financing plc [2020] EWHC 3613 (Ch) at [20]-[26].

287. Mr. Dicker QC buttressed that submission by reference to a US authority, Bank of America v 203 North LaSalle Street Partnership (1999) 526 US 434. In that case, the US Supreme Court considered a Chapter 11 plan which provided for the existing holders of equity in an insolvent partnership to be able to subscribe for new equity in the reorganised entity. The confirmation of the plan was opposed by an impaired senior lender, and the Supreme Court held that the plan violated the codification of the absolute priority rule in section 1129 of Chapter 11 of the US Bankruptcy Code. The reason was that the opportunity to subscribe for the new equity was "property received on account of" the claims of the existing equity, and that there had been no opportunity for anyone else to subscribe for the equity, so that the existing partners could not demonstrate that they had paid full value ("top dollar") for the equity.

288. I note in passing that the essential feature of all these cases that distinguishes them from the instant case is that the creditors who might have been unfairly outvoted in the scheme cases, and the impaired senior lenders in the North La Salle Street case, were all creditors who were in the money. That relevance of that point can be illustrated by the decision in DeepOcean at paragraph [64], in which, as I have set out above, Trower J held that the creditors who were out of the money in the relevant alternative had no basis for complaint that the shareholders of the plan companies were providing the funding which was to be used to pay them their returns under the plans. The same point can be made in the instant case in relation to the provision of £6 million of new equity by the Shareholders.

289. It is also clear that the North La Salle Street case turned on the interpretation of the codification in 1978 of the absolute priority rule which is now embodied in Chapter 11 of the US Bankruptcy Code. It is important to note that although it had been contemplated in the consultation process, an equivalent absolute priority rule was not enacted in any form as a principle for the exercise of the discretion in Part 26A.

290. But putting that aside, the other common feature of such cases is a concern that the creditors given the opportunity to "risk participate" in the scheme cases might be receiving something that could be described as "an incentive" (per Zacaroli J in Re New Look Financing plc) to skew the vote in the relevant class; or that the existing equity holders who had subscribed for new equity in the North La Salle Street case were not paying full value ("top dollar") for their new equity. In either situation, the underlying concern is not so much to impose a procedural requirement to offer an opportunity to all. The concern is that the terms of the "risk participation" or equity investment are not the best available, but include an element of disproportionate financial advantage or bounty for the relevant creditors which is not enjoyed by other similar or senior ranking creditors.

291. That point also appears from the "new value" principle to be found in the pre-1978 US cases discussed at length in the North La Salle Street case, based on a 1939 decision of the US Supreme Court in Case v Los Angeles Lumber Products 308 US 106. It was that principle which led the majority of the Seventh Circuit Court of Appeals in North La Salle Street to uphold the confirmation of the plan, and the essential issue in the Supreme Court was whether the principle had survived codification in 1978. That principle was explained in the judgment of Justice Douglas in the Lumber Products case as follows,

> "It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor … Where th[e] necessity [for new capital] exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made."

292. The point was also restated in In re Woodbrook Assocs, 19 F.3d 312, 319-320, (7th Cir. 1994):

> "The new value precept permits old equity owners to participate in a plan, without full payment to the dissenting creditors, if they make a new contribution (1) in money or money's worth, (2) that is reasonably equivalent to the value of the new equity interests in the reorganized debtor, and (3) that is necessary for implementation of a feasible reorganization plan."

293. In the instant case, and tracking such principles, Mr. Nicholson's evidence was that it was essential for the new money to be obtained by the Plan Companies and that it was highly unlikely that the terms upon which the Shareholders have agreed to lend such new money to the Group would have been available in the market. There was, he suggested, thus no sense in which the Shareholders would be receiving favoured treatment, but that they were paying a full and appropriate price for retaining their equity in the Plan Companies.

294. In that regard, Mr. Nicholson's evidence traced the course of negotiations in February 2021 in which the Secured Creditors had rejected any suggestion that £45 million of new money should be lent to the Group on a *pari passu* basis with their existing secured indebtedness under the Senior Facilities Agreement, and the Shareholders accordingly realised that they would have to take greater risks and contribute more themselves to the Restructuring than they had previously contemplated.

295. Mr. Nicholson's written evidence then also referred to the fact that the £45 million of new money to be advanced by the Shareholders would rank junior to the secured debt owed to the Secured Creditors under the Senior Facilities Agreement, and he pointed out that tranches of the secured debt had been traded at about 75p/£ even after announcement of the Restructuring. He therefore drew the conclusion that the new money advanced by the Shareholders would be at material risk after the Restructuring.

296. Mr. Nicholson adhered to his evidence in cross-examination, and, when asked about his approach to restoring value to shareholders in restructurings, stated,

> "I would like to put the business into a position where it had a very robust balance sheet and there was equity on day 1. I am in a situation, I am afraid, in the world in which I work where beggars cannot be choosers. I will get the best deal I can out of the shareholders and get the money in the best form I can to be able to secure the future of [the company]. I believe we have got to a position here where we have got an environment where the Shareholders have been prepared to invest on terms that I do not believe were available in the market in any way shape or form

> from anyone else. I do not believe anyone else would have put that money in. I believe the deal that we have done with the Shareholders and the Secured Creditors, given the resilience features that are in those facilities and the plans as put forward, secure the future of the business in uncertain times."

297. Mr. Nicholson's evidence was not seriously challenged and I had no other evidence as to the terms upon which £45 million of new money might have been obtained in the market from any other source, still less that it might be obtained on better terms. I therefore accept his evidence.

298. I am fortified in this conclusion by two further pieces of evidence. First, Mr Nicholson described in his evidence that, in the course of the negotiations in February 2021, one of the options put forward by the Secured Creditors was that they would lend new money on a super senior basis, with a view to a Secured Creditor-led restructuring commencing in May 2021 (as part of which the Secured Creditors would take equity in the Plan Companies).

299. Second, Mr Bucknall's evidence was that when various third-party investment funds approached Ethos to discuss possible investment between January and March 2021, three of them made proposals that involved funding on a super-senior basis and, where specific terms were proposed, they were significantly more onerous for the Group than the terms of the Shareholder funding being contemplated.

300. Even putting aside the fact that the AHG Landlords are out of the money, I therefore do not conclude that the retention of equity by the Shareholders on the terms of the Restructuring should have led me to exercise my discretion to decline to sanction the Plans at the request of the AHG Landlords.

Other discretionary factors

301. I should finally deal with certain other discretionary factors the Court will consider in deciding whether to sanction a plan.

302. First, on the fair representation of creditors, in DeepOcean at [53], Trower J said:

> "Furthermore, I think that 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 remain material questions, whether or not section 901G is engaged. They inform the court as to the weight to be given both to the views of the class meetings which have agreed the restructuring plan and the views of the dissenting class."

303. I agree that this is the correct approach. The voting outcomes in the instant case raise some interesting questions in this regard. In respect of the Secured Creditors and the Class A Landlords, the Plans were approved by large majorities in respect of each Plan. However, the Plans were not approved by 75% in value of the Landlord Creditors in Classes B through E, nor by the General Property Creditors.

304. Mr Dicker QC placed some reliance on the voting outcomes, observing that the Plans were rejected by every one of Classes B through E of the Landlord Creditors and by the significant majority of General Property Creditors. He emphasised that, at five Plan meetings, not a single creditor voted in favour of the Plans, a situation he described as "*extraordinary*".

305. The Plan Companies submitted that there is nonetheless significant support for the Plans among creditors as a whole, and argued that many of the dissenting votes were cast by creditors with a particular agenda who were not necessarily acting *bona fide* in the interests of the class in which they were voting.

306. In relation to the first of those submissions, it is right that the VAHL and VAL Plans were each approved by 77% by value of all Plan Creditors across all classes voting at the meetings, and the VAHCL Plan was approved by approximately 72% by the same metric.

307. As to the second submission, the Plan Companies pointed to the example of British Land, a member of the AHG Landlords. Entities controlled by British Land are landlords of properties in Classes A, B and D. Those entities voted against the Plans at all of the Plan Meetings, notwithstanding that the Class A Landlords will be paid in full (including arrears and future rent) and the Class B Landlords will only have their arrears compromised (an outcome which the Plan Companies contend is significantly better than in the relevant alternative). It was submitted by the Plan Companies that British Land, and the entities it controls, could not have been acting in their capacity as a Class A (or Class B, as relevant) Landlord when voting against the Plans, and that it must have been acting in some other capacity (for example, to promote its interests as a Class D Landlord or, more likely, to promote some wider objective of discouraging restructuring plans by other tenants). In their written submissions, the same point was given a literary-historical twist: "*The AHG Landlords are apparently attempting to block the Restructuring Plans pour encourager les autres*", with the Plan Companies cast in the unfortunate role of Admiral Byng.

308. As to the votes in the dissenting classes, the Plan Companies pointed out that it would have been in each Plan Creditors' rational economic interest to vote in favour of the Plans. In spite of the extensive submissions and voluminous evidence on behalf of the AHG Landlords, however, no representative of that group (including British Land) adduced any evidence explaining why they (or others like them) in fact voted against the Plans in these circumstances.

309. Mr Smith QC suggested numerous possible reasons: that creditors had misunderstood what they were being offered, that they do not like restructuring plans in principle, or that they simply concluded it was not worth the candle in circumstances where they would receive only a minimal return under the Plans (even if that minimal return is better than the relevant alternative).

310. In the absence of any evidence clarifying the issue, however, these issues remain a matter of speculation. The result is that I attach little weight to the numerical opposition to the Plans in the lower-ranking classes.

311. Ultimately, the overall support for the Plans and the question of whether creditors were fairly represented at the class meetings must be seen in its proper context in relation to

each class. There was no suggestion that the Secured Creditors and Class A Landlords were not fairly represented and, in each case, they supported the Plans by an overwhelming majority. For Class B Landlords, 11 of the 17 voted in favour, and the voting outcome was largely determined by two Landlords, one of which was British Land (with a claim worth slightly less than 50% of the overall value of Class B claims, such that it had the ability to block approval by the requisite majority in that class in any event). For Classes C through E and for General Property Creditors, the key point is that they are all out of the money and for the reasons that I have explained at length, little or no weight should be placed on their votes, and certainly not so much weight that it should cause me to decline to sanction the Plans.

312. I am fortified in that assessment by the provision in section 901C(4) that plan companies are entitled not to invite creditors to a meeting if the court is satisfied that none of the members of that class has a genuine economic interest in the company. Having concluded as I have in this judgment that the dissenting classes are out of the money, it is now (but only now) apparent that the Plan Companies could have relied on section 901C(4) to promulgate the Plans without inviting those classes to vote, thus eliminating the need to rely upon the court's cross-class cram down jurisdiction at all. (Of course, had they taken that approach, they would doubtless have been faced with precisely the same objections to their assessment of the relevant alternative and the "no worse off" test at a preliminary stage.)

313. I am also satisfied that there is no "blot" in the Plans and no party has suggested otherwise. In this context, a "blot" is a technical or legal defect in the Plans, such that the terms are, for example, rendered inoperative or ineffective by virtue of their infringement of a mandatory provision of law: see, for example, Re The Co-Operative Bank Plc [2017] EWHC 2269 (Ch) at [22]; and Virgin Atlantic (sanction) at [70].

314. The final discretionary factor I must consider is whether the Plans are likely to have a substantial effect in relevant jurisdictions outside England & Wales. The same question arises on an application to sanction a scheme of arrangement. I agree with Trower J that there is no reason why the same principles should not be applied to applications to sanction restructuring plans under Part 26A as apply in the scheme context: see DeepOcean at [67], referring to the statement of principle given by David Richards J in Re Magyar Telecom BV [2014] BCC 448 at [16]. I also took the same approach in Virgin Atlantic at [71]-[75].

315. On the facts of this case, the Plan Companies are incorporated in England and the vast majority of the debts compromised by the Plans are governed by English law (including all of the Leases and the debts owing to General Property Creditors, save for a small number of minor exceptions). I accept the Plan Companies' submission that this makes it inherently likely that the Plans will be recognised overseas: see RE PJSC Commercial Bank "Privatbank" [2015] EWHC 2399 (Ch) at [17], per David Richards J.

316. Further, and in any event, the Plan Companies have obtained independent expert evidence that the Plans are likely to be recognised internationally in those jurisdictions where there are non-UK guarantors of the Senior Facilities Agreement (namely, Singapore, Australia and Italy) and in those jurisdictions whose law governs a small number of lease guarantees (Spain and Portugal). That evidence is unchallenged. I am therefore satisfied that the Plans will have substantial effect.

Conclusion

317. In summary, I conclude that:

i) Each Plan Company has encountered financial difficulties that are affecting its ability to carry on business as a going concern.

ii) Each Plan is a compromise or arrangement between the relevant Plan Company and certain of its creditors, the purpose of which is to eliminate, reduce or prevent, or mitigate the effect of, those financial difficulties.

iii) The relevant alternative to the Plans would, in each case, be entry into administration followed by an accelerated sale of the businesses of the Plan Companies.

iv) If the Plans are sanctioned, no member of a dissenting class will be any worse off than they would be in the relevant alternative.

v) The Plans have been agreed by a number representing 75% in value of a class of creditors, present and voting, who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative.

vi) In all the circumstances, the Court should exercise its discretion to sanction the Plans.

318. I will therefore sanction the Plans in the terms sought.