THE MODERN LAW REVIEW
Modern Law Review
DOI: 10.1111/1468-2230.12767





# ARTICLE

# Selective Corporate Restructuring Strategy

Sarah Paterson* and Adrian Walters†

This article engages with a fundamental, but under-theorised, fact: that modern UK and US corporate restructuring plans frequently impair only selected creditors, and frequently treat impaired creditors of equal rank differently. It starts from the premise that selectivity and differential treatment, while often justifiable, raise normative questions about the boundaries within which they ought to be permitted. It then reviews selective and differential strategies in three UK restructuring procedures, using US chapter 11 as a comparator. The core contention is that selectivity and differentiation are best regulated by the threat of independent review against a menu of relevant criteria. A menu of criteria is developed, designed to distinguish legitimate and illegitimate uses of selective and/or differential strategies, and these criteria are mapped onto the various UK restructuring law procedures and US chapter 11. The article concludes with some limited suggestions for reform directed mainly at the UK company voluntary arrangement.

## INTRODUCTION

This article engages with a fundamental, but under-theorised, fact: that modern corporate restructuring generally, and UK and US corporate restructuring specifically, are frequently processes in which only selected creditors are impaired by the restructuring plan, and which frequently treat impaired creditors who would have the same distributional priority in a corporate insolvency process differently. This contrasts with a view of corporate insolvency as a collective process, in which individual creditors' rights of enforcement are suspended for the good of the general body of creditors; in which all creditors participate; and in which the proceeds of realisation of the assets are distributed *pari passu* in accordance with the order of priority prescribed by corporate insolvency

*Professor of Law, the London School of Economics and Political Science.
†Professor of Law, Chicago-Kent College of Law, Illinois Institute of Technology; Professor, Nottingham Law School, Nottingham Trent University. We extend our thanks to participants in a virtual symposium hosted by Arizona State University and a faculty workshop at Chicago-Kent; to Daniel Bussel and his colleagues for assistance with materials on assumption; to Vincent Buccola and Chris Howard for comments on earlier drafts; to Alan Kornberg for helpful views on the position on the ground; to Caitlyn Worley (Chicago-Kent class of 2022) for research assistance; and to our two anonymous reviewers for some excellent insights. All views expressed are, of course, our own and we are responsible for any errors.

law.[1] It will be immediately apparent that a restructuring procedure in which certain creditors are selected by the debtor to absorb the loss while others ride through either wholly unaffected or barely impaired raises very different issues of distributional fairness from an insolvency procedure in which all creditors participate. Moreover, the different treatment of creditors who would be of equal rank in corporate insolvency law's distributional order of priority raises quite different issues from controversies over the distributional order of priority itself. Yet, with a few notable exceptions, selective corporate restructuring strategies have received relatively little attention from corporate restructuring law scholars.

One such exception, in the US context, is Kevin Delaney's excellent book, *Strategic Bankruptcy*.[2] Delaney adopts a case study approach, analysing one case in which the debtor turned to US corporate restructuring law to compromise the claims of tort claimants,[3] and another case in which the debtor turned to US corporate restructuring law to compromise the claims of employees.[4] In both of these cases, Delaney suggests that the debtor's mobilisation of corporate restructuring law was illegitimate because it imposed losses on creditors with weak bargaining power while allowing stronger, better informed creditors to emerge reasonably unscathed, at a point in time when the debtor was still meeting its liabilities in full. Another exception is work by Mark Roe and Frederick Tung which engages with many of the mechanisms in US law which can produce the differential treatment of otherwise similarly situated creditors with which we are concerned.[5] Roe and Tung focus on the ways in which certain unsecured creditors are able to mobilise tools in the US Bankruptcy Code to gain a distributional priority advantage over other unsecured creditors who would otherwise rank equally with them. And a final exception is Vincent Buccola's conception of two paradigms operating in US chapter 11: a paradigm operating early in the case that prioritises keeping the business running over distributional consequences, and a second paradigm operating at the conclusion of the case orientated towards observing distributional entitlements.[6]

Unlike Delaney, we do not focus on cases where selectivity and differential treatment of otherwise equally ranking creditors uniquely harm creditors with weaker bargaining power. Unlike Roe and Tung, we focus on the debtor, and do not assume that all selective strategies are motivated by attempts by one creditor to capture value from another. And, while our work intersects with Buccola's, we suggest that the debtor should face the threat of court review of

1 See, for example, *Leyland DAF Limited* v *Talbot* [2004] UKHL 9; [2004] 2 AC 298 at [28]. Of course, as one of our anonymous reviewers noted, the notion of collectivity in corporate insolvency law has always been nuanced – for example, in a compulsory liquidation in England and Wales secured creditors are not bound by the stay (see Insolvency Act 1986, s 130(2) and *In re David Lloyd & Co* (1877) 6 Ch D 339, 343-346) and, until it was largely abolished in 2002, administrative receivership functioned primarily as a secured creditor enforcement remedy.

2 Kevin J. Delaney, *Strategic Bankruptcy: How Corporations and Creditors Use Chapter 11 to their Advantage* (Berkeley and Los Angeles, CA: University of California Press, 1998).

3 *ibid*, 60-81.

4 *ibid*, 82-125.

5 Mark Roe and Frederick Tung, 'Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain' (2013) 99 *Va L Rev* 1235.

6 Vincent S.J. Buccola, 'The Janus Faces of Reorganization Law' (2018) 44 J Corp L 1.

its selective or differential strategy whenever it occurs in the case. Overall, we advance a framework for distinguishing legitimate and illegitimate uses of selective restructuring tools that directly addresses UK restructuring law. While Horst Eidenmüller has noted the difficulty of articulating what 'collective' means in a modern context,[7] and one of us has recently published a monograph analysing in detail cases in which only sophisticated finance creditors are affected by the reorganisation plan, and unsecured creditors such as trade creditors, who are creditors of the operating business, suffer no losses,[8] there is very little literature engaging with the issues of selectivity and differential treatment in a broader UK restructuring context and, even in the US, the literature is nascent.[9]

UK restructuring and insolvency law[10] offers a range of procedures which can be used alone, or in combination, to restructure a debtor's liabilities, sell its business and assets as a going concern, or sell its assets on a break-up basis. The proceedings that facilitate going concern asset sales have roots in insolvency law. The basic template is winding-up – the assets are 'liquidated' – but the aim is to realise more for the assets and thus provide a greater return for creditors, while offering the possibility of spill over benefits, such as continuity of supply chain relationships and employment. On the other hand, the procedures to restructure or reorganise liabilities owe their origins more to the law of debt composition, and these regimes have voting mechanisms, configured in various ways, that enable creditor majorities to impose a restructuring or reorganisation plan[11] on dissenting minorities to overcome holdout problems that would otherwise afflict a composition or 'workout', that under ordinary law requires unanimous creditor consent. In sum, UK restructuring and insolvency law offers a spectrum of business continuation and cessation proceedings: at one end, proceedings to restructure liabilities built on the foundation of debt composition; at the other end, proceedings to liquidate and distribute the assets of a defunct corporate debtor; in between proceedings for going concern sales, and various hybrids – that is proceedings that can be used, alone or in combination, both to realise assets and restructure liabilities. US chapter 11 differs from UK restructuring and insolvency law because it offers a single gateway to this panoply of formal

7 Horst Eidenmüller, 'What is an Insolvency Proceeding' (2018) 92 Am Bankr LJ 53, 65.

8 Sarah Paterson, *Corporate Reorganization Law and Forces of Change* (Oxford: OUP, 2020).

9 For other examples which touch the issues with which we are concerned see for example David A. Skeel, Jr. 'The Empty Idea of "Equality of Creditors"' (2017) 166 U Penn LR 699; Vincent S.J. Buccola, 'Unwritten Law and the Odd Ones Out' unpublished manuscript at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3967191 (last visited 13 September 2022).

10 For ease we characterise the law in the Insolvency Act 1986 (IA 1986) and Parts 26-26A of the Companies Act 2006 as 'UK law'. Strictly, IA 1986 applies only to corporate insolvencies in England and Wales, and with minor differences, inconsequential for the purposes of this article, in Scotland. See IA 1986, ss 440-441. Nevertheless, Northern Ireland's corporate insolvency law found in the Insolvency (Northern Ireland) Order 1989 SI 1989/2405 (NI 19) is, for all relevant purposes, identical and subsequent amendments thereto are in line with amendments to IA 1986. Parts 26-26A apply to the whole UK: see Companies Act 2006, s 1299.

11 The terms 'restructuring' and 'reorganisation' are interchangeable with the former more reflective of UK usage and the latter more reflective of US usage. From here on we typically use 'restructuring' to avoid duplication, except in certain places where we are referring exclusively to US practice.

interventions.[12] Yet both regimes offer a similar spectrum of possibilities for the financially distressed debtor within the interstices of formal law.

This spectrum of possibilities maps onto what one of us elsewhere has described as the 'demise curve' of a distressed business.[13] The demise curve tracks the descent of the business into financial distress and insolvency. What may start as an isolated problem will deepen if not addressed. For example, the debtor may face significant product liability or labour costs which the directors consider to be unsustainable. Or there may be a problem in the company's long-term financing: a bond that will come due in the medium term entered into on a set of assumptions about the company's future revenues that have become questionable in real world market conditions.[14] In our present era, the problem may be a large leasehold estate which a retailer, casual dining operator, or hospitality business can no longer afford because of competition, changing shopping habits, or the effects of the COVID-19 pandemic. As distress deepens, the debtor's specific financial challenge risks becoming a more generalised challenge in meeting its liabilities. Thus, further down the curve, if nothing is done, the company will reach a point of general default. Lacking the cashflow to pay its financial and operating creditors, the company will descend into a state of insolvency and the risk of the infamous race among creditors to enforce their claims will correspondingly increase.[15] If the company is freefalling into insolvency, the business will be hard to save. Higher up the curve, however, restructuring law's spectrum provides for a range of formal interventions that well-advised companies can use to ride out their problems and continue their businesses. These interventions will invariably involve at least some forms of proceeding that aim, in whole or part, to restructure liabilities.[16]

12 To the extent that there are meaningful alternatives to chapter 11 for corporate debtors, aside from a chapter 7 piecemeal liquidation, they are to be found in state law which lacks the inbuilt advantages and nationwide enforcement potential of federal law and federal court jurisdiction. See generally Stephen J. Lubben, *The Law of Failure: A Tour Through the Wilds of American Business Insolvency Law* (Cambridge: CUP, 2018).

13 Irit Mevorach and Adrian Walters, 'The Characterization of Pre-Insolvency Proceedings in Private International Law' (2020) *21 EBOR* 855, 857.

14 Paterson, n 8 above, 57-59.

15 For the classic account of the so-called 'grab race' or 'race of diligence', which dominates the literature, and corporate insolvency law's role in preventing it, see Thomas H. Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 Yale LJ 857; Thomas H. Jackson, 'Translating Assets and Liabilities to the Bankruptcy Forum' (1985) 14 J Legal Stud 73; Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge, MA: Harvard University Press, 1986). Of course, as one anonymous reviewer highlighted, mechanisms do exist which can, in certain circumstances, deter such a race. For example, in some cases all-asset security may serve to prevent other creditors from rushing to grab the assets: see Julian Franks and Oren Sussman, 'Financial Distress and Bank Restructuring of Small to Medium Size Companies' (2005) 9 *Review of Finance* 65, 66-67; John Armour and Sandra Frisby, 'Rethinking Receivership' (2001) 21 OJLS 73, 87; and Randal C. Picker, 'Security Interests, Misbehavior, and Common Pools' (1992) 59 U Chi LR 645, 669-675.

16 Some commentators have suggested that going concern auction sales may be preferable to potentially costly restructuring proceedings as a method to preserve value: see, for example, Douglas G. Baird and Robert K. Rasmussen, 'The End of Bankruptcy' (2002) 55 Stan L Rev 751, 786-788. Insofar as a sale methodology involves cherry-picking by the buyer whereby some unsecured creditors are kept whole and continue with the business while other unsecured creditors are left

To use restructuring law's tools successfully, the debtor company must develop a strategy for the restructuring, where strategy is (to borrow from the military strategy literature) 'concerned with ways to employ means to achieve ends'.[17] The debtor has limited resources (means) by which to achieve its ends (successful restructuring): the debtor is likely to face liquidity constraints which limit its cash resources to fund the direct costs of the restructuring case. An extensive body of literature engages with the ways in which multilateral bargaining in restructuring cases increases transaction costs, often to unsustainable levels.[18] An effective way to limit these costs is to reduce the size of what Freedman calls the 'circle of cooperation' required to reach an agreement.[19] In other words, the debtor company negotiates only with those creditors who must be compromised to avoid default and leaves as many other creditors as possible unaffected or barely affected by the plan. Only a debtor company which has not yet reached the point of general default will be able to pursue this selective strategy. Ultimately, the selective strategy reduces direct costs.

Furthermore, reducing the circle of cooperation makes the restructuring plan easier to agree because, to stretch the military metaphor, the debtor is not fighting on too many fronts. And selectivity can play an important role in the battle for hearts and minds of stakeholders which the debtor will need to stay on board after the restructuring is completed for it to be sustainable. First, selectivity enables a simple message to be given to creditors unaffected by the plan that they can be confident that, if they continue to deal with the company, they will not find themselves bearing losses in the future. Secondly, within a class of creditor which does suffer loss in the plan, creditors with greater commercial bargaining power can be offered the reassurance of a superior deal compared with others whose claims are of equivalent rank. If the debtor's stakeholders suffer widespread loss of confidence in the debtor over the course of the case, then any restructuring plan is likely to be short-lived in its effects as various groups steadily desert the debtor after the case has concluded. Thus, debtors who pursue selectivity and differential treatment of creditors who would rank equally in a corporate insolvency process may have an eye on the long-term effects of the restructuring plan rather than its short-term consequences. Overall, selectivity – that is, strategic decisions to engage with selected creditors rather than to engage with all creditors in the restructuring negotiation, and differential treatment – that is strategic decisions to allocate losses unevenly among creditors who would be of the same rank in corporate insolvency law's distributional order of priority – can readily be understood. Drawing again on the military strategy literature, we distinguish between what we might call 'all out corporate restructuring negotiations' (which will be costly and fraught) and 'limited

behind with claims against the sales proceeds that will yield a less than full recovery, it can be thought of as being functionally equivalent to a selective restructuring.

17 Arthur F. Lykke Jr, *Military Strategy: Theory and Application* (US Army War College, 1989) 3-8 cited in Lawrence Freedman, *Strategy: A History* (Oxford: OUP, 2013) xi.

18 See, for example, Paul M. Goldschmid, 'More Phoenix than Vulture: The Case for Distressed Investor Presence in the Bankruptcy Reorganization Process' (2005) Colum Bus L Rev 191.

19 Freedman, n 17 above, 612.

or targeted restructuring negotiations' (which reduce costs and maintain the confidence of selected creditors in the business).[20]

As we will see, both UK and US restructuring law furnish corporate debtors with mechanisms to facilitate a targeted, selective process, in which multiple creditors are left unimpaired and therefore uncompromised by the restructuring plan, and in which variable outcomes are agreed or imposed on different creditors of otherwise equal distributional priority. But this begs normative questions about the boundaries within which a debtor ought to be able to use these tools for selective and differential treatment. The original aim of our research project was to develop a menu of relevant criteria to distinguish legitimate and illegitimate uses of the tools.[21] However, as we will see, we have also arrived at the conclusion that it is crucial that a debtor pursuing a selective and/or differential strategy should be encouraged to take seriously the prospect of independent review of their plan against the relevant criteria. In many ways, this second conclusion is as important in our account as the development of the menu of relevant criteria itself.

We start, in the second part of the article, by analysing the various tools available in UK restructuring procedures, drawing explicit comparisons with the mechanisms available in US chapter 11 as we go. We have chosen US chapter 11 as our comparator because, as we will see, it provides a fundamentally different approach to both selectivity and differential treatment, which assists us in developing our menu of relevant criteria and our claims about independent review.[22] In the third part, we highlight the specific challenges posed by selective, differential treatment; why a menu of relevant criteria to place boundaries around use of these tools is needed; and why the threat of independent review of the debtor's selective or differential strategy against these relevant criteria is vital. We then develop a menu of relevant criteria and consider the extent to which the debtor has reason to fear independent review of their plan against these criteria in the various UK restructuring procedures and US chapter 11. Finally, we make some limited suggestions for reform.

What emerges is, so far as we are aware, the first, sustained investigation into the selective nature of corporate restructuring in the UK, and a comparison of the way in which UK and US restructuring law facilitates it. This is an issue of obvious importance for corporate restructuring and insolvency law specialists. Yet, we hope that we also reveal a matter of wider importance for scholars in other areas of the law that often intersect with restructuring and insolvency law,

20 For an outstanding analysis of the distinction between 'all out war' and 'limited war' from which we have developed this conceptual framing, see Freedman, *ibid*, particularly 125.

21 The term 'menu of relevant criteria' is inspired by Jennifer Payne and Janis Sarra, 'Tripping the Light Fantastic: A Comparative Analysis of the European Commission's Proposals for New and Interim Financing of Insolvency Businesses' (2008) 27 *Int'l Insolv Revi* 178.

22 We note that Article 8(1)(d)-(f) of the European Directive on Preventive Restructuring Frameworks (Directive (EU) 2019/1023 of the European Parliament and Council on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency)) explicitly contemplates selectivity and that many jurisdictions around the world have developed or are developing their own approaches to the issues discussed here. We hope that the analytical frame we develop will be useful in evaluating those different approaches.

from general corporate and finance law scholars to scholars in fields as diverse as property law, trust law, contract law, and tort law.

## SELECTIVE RESTRUCTURING STRATEGY MECHANISMS

In this part, we review how a selective strategy, which differentiates between creditors who would be of the same legal rank in corporate insolvency, can be operationalised in three separate UK procedures: Part 26 schemes of arrangement; Part 26A restructuring plans; and company voluntary arrangements (CVAs). Where relevant, we draw explicit comparisons with tools available in US chapter 11.

### Part 26 scheme of arrangement

A scheme of arrangement is a statutory procedure found in Part 26 of the Companies Act 2006[23] for effecting a compromise or arrangement between a company and its members and/or creditors with the sanction of the court. A company need not be insolvent to resort to the scheme, but the selective restructuring question is not as acute in the scheme of arrangement context as it is in some of the other English law procedures which we will consider. This is because creditors and/or members are divided into classes for the purposes of voting, based on the similarity of the rights which are to be varied or released by the scheme, and the similarity of the rights which they are to be granted (if any) pursuant to the scheme and, crucially, the statutory majority must be achieved in every class for the scheme of arrangement to be sanctioned by the court.[24] In practice, uneven treatment of creditors is therefore likely to fracture the non-financial unsecured creditor class and, unless the relatively high statutory majority in each class (a majority in number representing 75 per cent by value of those present and voting) support the proposal, the scheme will fail. Thus, creditors who have been selected for impairment and/or differential treatment have a higher level of control over the scheme's fate when compared with some of the other procedures we will consider below.

There is, however, no requirement for all creditors and/or shareholders of the company to be included in the UK scheme of arrangement. In *Sea Assets* v *Perushaan Perseroan (Persoe) PT Perusahaan Penerhanagen Garuda Ltd*[25], a case in which trade creditors and procurement contract creditors were left outside the scheme and therefore unimpaired, Gibson LJ stated: 'If the creditors within the Scheme think the proposal unfair to them and unduly favourable to those left outside the Scheme, they can vote against the Scheme. If the majority vote in favour of the Scheme, then a minority creditor has the opportunity to seek to persuade the court that the Scheme is unfair and should not be sanctioned.'[26]

23 Companies Act 2006, Part 26, ss 895-899.
24 *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241; [2002] BCC 300.
25 *Sea Asset* [2001] EWCA Civ 1696.
26 *ibid* at [45].

Schemes of arrangement proceed by way of several, clearly identified stages. In England and Wales these stages include an initial hearing, known as the convening hearing, and a second hearing, known as the sanction hearing.[27] At the convening hearing, the court considers whether the company has correctly identified classes of creditors and/or members for voting purposes. It does not consider the unimpaired creditors at this stage because, as indicated, the company is free to decide which creditors to include within the scheme and which to leave outside it.[28] If the statutory majority is achieved in each class, a second court hearing is held at which the court is asked to sanction the scheme. This is the stage at which a creditor included within the scheme can appear to argue that the scheme is unfair because – in Gibson LJ's words – it is 'unduly favourable to those left outside the scheme'.[29]

However, in examining the nature of the court's inquiry, it is important to scrutinise the rationale for imposing the compromise or arrangement on minority creditors who have voted against it. The main justification for imposing the arrangement on a dissenting class minority is the principle of majority rule. This informs the nature of the court's inquiry: in deciding whether to sanction the scheme or not the court asks itself whether it has any reason to doubt that the majority view represents the decision which a reasonable creditor would have arrived at when assessing the proposal. Thus, the court is concerned to ascertain whether members of the majority had a collateral interest, such as a connection with the company, which motivated them to vote in the way they did.[30] Similarly, the court will be focused on whether creditors had sufficient information to reach an informed decision,[31] and whether the company consulted appropriately with different groups of creditors.[32]

Having regard to the principle of majority rule, the court's starting point, then, is that the majority was not sufficiently concerned by the exclusion of some creditors to have voted the scheme down. And the court will be slow to differ with this view unless it has reason to do so. In sum, the focus is likely to be on the identity of the majority creditors and on questions of transparency and disclosure: did the company make clear that there were creditors who were left outside the scheme with a sufficient level of detail to enable the scheme creditors to take an informed decision when they voted?

27 Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006) [2020] 1 WLR 4493. The Practice Statement does not apply in Scotland, where there is no consideration of class issues at an initial hearing.

28 *In Re MyTravel Group Plc* [2004] EWCA Civ 1734; [2005] 2 BCLC 123.

29 It is also worth noting that creditors may be left outside the scheme as a first step in stranding them in an asset-less company. Stranding is achieved by 'twinning' the scheme with a pre-packaged administration sale: see Rodrigo Olivares-Caminal, John Douglas, Randall Guynn, Alan Kornberg, Sarah Paterson, and Dalvinder Singh, *Debt Restructuring* (Oxford: OUP, 2nd ed, 2016) 261. In this case, creditors who are left outside the scheme can appear at the sanction hearing to argue that the scheme is unfair because they ought to be included within it.

30 *Primacom Holding GmbH* v *A Group of the Senior Lenders & Credit Agricole* [2011] EWHC 3746 (Ch); [2013] BCC 201 at [49].

31 *Re Heron International* [1994] 1 BCLC 667, 672-673.

32 *Re Sunbird Business Services Ltd* [2020] EWHC 2493 (Ch); [2020] Bus LR 2371 at [23] and [103]-[123].

What emerges from this account can be characterised as a quasi-consensual process: while the majority within a class can impose the restructuring plan on the minority, a relatively high statutory majority of creditors must nonetheless agree to the plan for it to proceed to sanction. Creditors are similarly divided into classes in US chapter 11, and it is similarly possible that the statutory majority is achieved in each voting class so that the plan is quasi-consensual. However, it is also possible that the statutory majority is not achieved in one or more classes, but the court is nonetheless asked to confirm the chapter 11 plan of reorganisation over the objection of the dissenting class(es) using its so-called cross-class cram down power. We will see shortly that the UK now offers a separate restructuring procedure, the Part 26A restructuring plan procedure, in which the court can be asked to sanction a plan over the objection of a dissenting class. However, a significant difference between the jurisdictions is that in the UK a debtor will typically only commence a scheme of arrangement procedure if it is confident it will achieve the statutory majority in each voting class.[33] Where it has concluded that it may need to rely on the court's cross-class cram down powers it will turn, instead, to the Part 26A restructuring plan procedure. In contrast, other than in so-called pre-packaged chapter 11 plans, in the US the debtor will frequently file for chapter 11 at the outset of negotiations and will only determine, as the case unfolds, whether it will achieve consensus in every voting class or not.[34] We will see, in the next section, that this is of some importance for the way in which debtors mobilise mechanisms available in US chapter 11 to achieve selective or differential treatment.

## Part 26A restructuring plans

The new Part 26A restructuring plan procedure was introduced by the Corporate Insolvency and Governance Act 2020 (the CIGA 2020).[35] It is closely modelled on the scheme of arrangement, but with several, significant differences including the introduction of a power for the court to impose the restructuring plan on an entire dissenting class. Crucially, this cross-class cram down power heightens the risks associated with a selective restructuring case because there is no longer the guard rail that a significant, statutory majority of each class of impaired creditors has voted to support the deal. This increases the concern that companies may be tempted to use the cram down feature to write off debts to benefit the remaining creditors and equity holders who do not suffer a write down of their claims in the plan.

33 As noted in n 29 above, it is possible that the company may seek to 'twin' the scheme of arrangement with a pre-packaged administration sale to 'strand' out of the money creditors. However, schemes twinned with pre-packs are not common and may become rarer still now that Part 26A offers the possibility of cross-class cram down.

34 For the increasing importance of pre-packaged chapter 11 plans see Baird and Rasmussen, n 16 above; Douglas G. Baird and Robert K. Rasmussen, 'Chapter 11 at Twilight' (2003) 56 Stan L Rev 673; Vincent S.J. Buccola, 'Bankruptcy's Cathedral: Property Rules, Liability Rules, and Distress' (2019) 114 Northwest Univ L Rev 706, 727-732.

35 Corporate Insolvency and Governance Act 2020, s 7 and Sch 9.

Unlike schemes of arrangement, the new Part 26A restructuring plan procedure does include two threshold financial conditions.[36] This also contrasts with the formal position in US chapter 11, where a cross-class cram down power is available[37] but where the Bankruptcy Code does not require the debtor to make a showing of insolvency or likelihood of insolvency as a threshold to entry to the US bankruptcy system. The barrier to entry is low: debtors are eligible to file a chapter 11 case if they are US domiciled, or have a place of business, or property, in the US.[38] This encourages prompt intervention higher up the demise curve before distress spreads and deepens. However, the case can be dismissed if the filing was made in bad faith, which encompasses situations in which the debtor is unable to demonstrate a valid reorganisation purpose.[39] Thus, US law has mechanisms for screening out cases that would not meet the UK's threshold conditions despite not having equivalent pre-conditions in its formal law.

Part 26A specifically provides that, 'Every creditor or member of the company whose rights are affected by the compromise or arrangement must be permitted to participate' in the plan meetings.[40] This raises the question whether creditors can be excluded from voting on the plan where their rights will be unimpaired by it. No definition of 'affected' is offered, and in *Re Hurricane Energy Plc* Zacaroli J adopted a relatively broad reading, so that shareholders whose shares were untouched formally but who were to be heavily diluted by the plan were 'affected by it' and therefore required to be included in the vote.[41] Notably, however, anecdotal reports from at least one practitioner present in the court room suggest that, during the convening hearing, Zacaroli J appeared to accept that 'affected' must mean 'negatively affected' so that creditors who were unimpaired and not negatively affected would not be required to vote on the plan. Although Zacaroli J did not ultimately make this point in the judgment, we suggest that it is right that unimpaired creditors should not vote where their rights are unaffected in form and substance, and they have no interest that needs to be safeguarded by participation. This is consistent with the position in section 1126(f) of the US Bankruptcy Code, which provides that unimpaired creditors are deemed to have accepted, and do not vote on, the plan.[42]

Thus far, we discern no material difference between the ability to exclude creditors who will be paid in full, and therefore left unaffected, in either a Part 26

36 Companies Act 2006, Part 26A, s 901A. Condition A is that 'the company has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern'. Condition B is that '(a) a compromise or arrangement is proposed between the company and (i) its creditors or any class of them, or (ii) its members, or any class of them, and (b) the purpose of the compromise or arrangement is to eliminate, reduce or prevent, or mitigate the effect of, any of the financial difficulties … in Condition A'.

37 11 USC §1129(b). The chapter 11 cram down power was one source of inspiration for the power in Part 26A.

38 11 USC § 109(a), (d).

39 11 USC § 1112; See also *In re SGL Carbon Corp* 200 F 3d 154 (3rd Cir 1999); *In re National Rifle Association of America* 628 BR 262 (Bkrtcy. N.D. Tex. 2021).

40 Companies Act 2006, Part 26A, s 901C(3).

41 *Re Hurricane Energy Plc* [2021] EWHC 1418 (Ch) at [27]-[34].

42 Multiple factors may lead to impairment of a claim. So, for example, if the debtor proposes to pay in full, but over time, a claim which long since fell due, the claim will still be treated as impaired because the extension of time to pay alters the creditor's contractual rights. See 11 USC § 1124.

scheme of arrangement or a Part 26A restructuring plan procedure. Indeed, the Explanatory Notes which accompany the CIGA 2020 are instructive: 'While there are differences between the new Part 26A and existing Part 26 … 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.'

Thus, we can expect the courts to read across from Gibson LJ's dicta in *Sea Assets*.[43] Nonetheless, we suggest that the cross-class cram down power in Part 26A somewhat changes the nature of the court's inquiry at the sanction hearing. In a Part 26 scheme, as we have seen, the court inquires whether there is reason to doubt, or go behind, the majority vote. It will be particularly concerned to ensure that there was adequate disclosure that certain creditors have been excluded. Transparency will be just as important in a Part 26A hearing to sanction a cross-class cram down plan, but the court must also decide whether it was objectively fair to exclude the creditors.[44] In other words, we expect Part 26A cross-class cram down plans to attract heightened court scrutiny.

The early Part 26A running conforms to expectation. In the first case in which permission to convene meetings to consider a Part 26A cross-class cram down plan was sought, Trower J carefully listed all excluded claims and noted that no one had argued the absence of 'good commercial reasons' for excluding them.[45] In the convening hearing for *Re Virgin Active Holdings Ltd* (*Virgin Active*), another cross-class cram down case, Snowden J referred to 158 trade creditors owed about £2.2 million who were considered 'commercially necessary for the continuation of the Group's business'.[46] He noted that the debtor was not proposing to compromise amounts owing to trade creditors, tax authorities, employees, or local authorities for rates.[47] At the sanction stage, he noted further that the decision to pay these creditors in full, 'and the commercial judgment which underpinned [that decision]' was not challenged by the dissenting class.[48]

However, examination of excluded, unimpaired creditors is also emerging in cases where the cross-class cram down power is not engaged. In the convening hearing for *Re Virgin Atlantic Airways Ltd*, Trower J noted the exclusion from the plan of more than 1,000 creditors with claims of under £50,000 for reasons of 'logistical difficulties'; public bodies with claims for liabilities such as air traffic control charges required for the continuation of the company's business; creditors such as sales agents whose goodwill was similarly essential for business continuity; and suppliers with whom the company had reached agreement at or below the level proposed in the plan.[49] At the sanction stage, Snowden J agreed that all of these creditors had been excluded for 'respectable commercial reasons'.[50] He focused, particularly, on the logistical burden of bringing

43 Text to nn 25-26 above.
44 See *Re Virgin Active Holdings Ltd* [2021] EWHC 814 (Ch) at [62].
45 *Re DeepOcean 1 UK Ltd* [2020] EWHC 3549 (Ch); [2021] Bus LR 632 at [11]-[12].
46 *Virgin Active* n 44 above at [11].
47 *ibid*.
48 *Re Virgin Active Holdings Ltd* [2021] EWHC 1246 (Ch); [2022] 1 All ER (Comm) 1023 at [264].
49 *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2191 (Ch); [2020] BCC 997 at [11] (judgment on convening hearing).
50 *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2376 (Ch); [2020] BCC 997 at [67] (judgment on sanction hearing).

numerous creditors with small claims into the plan and, specifically, the company's explanation in the explanatory statement that ' … the cost savings to be borne by including those below £50,000 are outweighed by the practical time and cost of including them'.[51]

We suspect that, as it becomes usual practice for the court to review unimpaired creditors in Part 26A restructuring plans even where the cross-class cram down power is not engaged, this will also become a regular feature in schemes of arrangement, even where no specific challenge on the issue has been raised. We will return to this issue later but suffice to say, for the moment, that we endorse court inquiry into and review of the exclusion of creditors in scheme cases as well as in Part 26A restructuring plans.

As indicated above, section 1126(f) of the US Bankruptcy Code also expressly permits a debtor to leave a class, or classes, of creditor unimpaired. It states: 'Notwithstanding any other provision of this section, a class that is not impaired under a plan is deemed to have accepted the plan, and solicitation of acceptances with respect to such class from the holders of claims or interest of such class is not required.'

Thus, the simplest way in which a class of creditor may be left unimpaired is if that is what is provided in the plan. If the statutory majority is achieved in each voting class, then this raises no special difficulties. However, where the court's cross-class cram down power is engaged, two specific requirements for plan confirmation (the US equivalent of sanction) are triggered: that it does not discriminate unfairly and is fair and equitable with respect to each dissenting, impaired class.[52] There is no definition of unfair discrimination in the US Bankruptcy Code but it is generally interpreted as a mandate that dissenting classes should receive relatively equal value in the restructuring plan compared with other similarly situated classes.[53] The requirement that the plan is 'fair and equitable' engages the so-called absolute priority rule: very broadly that no junior class should recover until a senior class has recovered in full and, as a corollary, that no senior class should recover more than it is owed.[54] If certain unsecured creditors are selected to form an impaired class, while others are compromised in the plan, and the statutory majority in favour of the plan is not achieved in each voting class, then the debtor will need to justify why its selective and differential treatment meets the requirement for no unfair discrimination and fair and equitable treatment. This is likely to be a costly exercise and an unattractive prospect, so that a debtor is probably only incentivised to identify unsecured creditors as an unimpaired class when it is confident that it will achieve a consensual plan.

It is also worth noting, however, that if the debtor is confident that it will achieve the statutory majority in each voting class, and that the supportive creditors are content to designate unsecured creditors as an unimpaired class, the debtor may have little cause for concern that there will be any review of its decision-making. We note that this contrasts with the early signs that courts

51 *ibid* at [65]-[66].
52 11 USC § 1129(b).
53 Olivares-Caminal et al, n 29 above, 171.
54 *ibid*, 171-172.

are inclined to inquire into selective and differential treatment in UK Part 26A restructuring plan procedures even where the court's cross-class cram down power is not engaged, and the potential for this practice to increase by process of cross-fertilisation in schemes of arrangement. And we note that a so-called 'consensual plan' may often be more accurately described as quasi-consensual, given that a 'consensual plan' is certainly not always one which is supported unanimously by affected creditors. We will return to this in our conclusions but, for the moment, note, once again, our approval of the threat of independent review of selective and differential treatment even where the vote is achieved in every voting class

The second way in which a debtor can leave creditors unimpaired in a US chapter 11 plan is by designating an 'administrative convenience class'. Section 1122(b) of the US Bankruptcy Code provides that: 'A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.'

Thus, section 1122(b) authorises a debtor to leave claims unimpaired where the costs of including the claims outweigh its benefits, echoing Snowden J's comments in the *Virgin Atlantic* case. The Bankruptcy Code contains no explicit restriction on the size of the administrative convenience claim and debtors do promulgate plans with large administrative convenience claims.[55] However, once again, if the plan is ultimately non-consensual, and the unfair discrimination and fair and equitable standards are engaged, the debtor may face significant inquiry into its decision to identify administrative convenience claims. In other words, unless the debtor is confident that the plan will be consensual, it is not incentivised to make expansive use of the ability to designate an administrative convenience class for anything other than small claims.

This, of course, leaves open the question of what happens if the debtor is confident that the plan will be consensual – a situation which we have suggested is more accurately described as quasi-consensual. Section 1122(b) expressly contemplates review of administrative convenience claims by the court on a 'reasonable and necessary' standard in every case and yet it appears that this does not happen in practice unless a creditor raises an objection.[56] In other words, while UK schemes of arrangement and Part 26A restructuring plans are increasingly adopting a quasi-inquisitorial approach to selective and differential treatment in every case (which we endorse), in US chapter 11 the debtor has good reason to consider selective and differential treatment with care where it fears adversarial inquiry in the context of a non-consensual plan, but much less to fear by way of independent review of its decision-making process in a quasi-consensual situation.

Nonetheless, unless the debtor is confident that it will be in consensual or quasi-consensual plan territory, neither of the mechanisms for leaving creditors unimpaired in the chapter 11 restructuring plan is particularly attractive. There

55 Brad B. Erens and Timothy W. Hoffman, 'The Triumph of the Trade Creditor in Chapter 11 Reorganizations' (2013) 9 Pratt's J Bankr L 3, 26.

56 *ibid*. See for example *In re Tuscon Self-Storage, Inc* 166 BR 892 (BAP 9th Cir 1994).

are, however, also mechanisms which can be used in the chapter 11 case to achieve similar results. First, debtors can apply by motion for first day orders granting the court's permission to pay pre-petition debts owing to so-called 'critical vendors' – vendors whom the debtor insists need to be paid to send a 'business as usual' message and assure continuity of supply. The debtor's designation of some vendors as 'critical' to its reorganisation sorts among unsecured creditors and produces different results for different vendors notwithstanding that all of them would have the same distributional priority in insolvency: a selected class of pre-petition claims that would otherwise be written down, at best, to cents on the dollar along with other claims of equivalent rank, gets paid in full, as part of the administration of the bankruptcy case, before confirmation of a reorganisation plan, while the others absorb the loss.

Bankruptcy courts have tended to anchor their jurisdiction to grant critical vendor orders principally by section 363(b)(1) of the Bankruptcy Code which authorises the court to approve the use, sale, or lease of estate property other than in the ordinary course of business, combined with the court's general power in section 105(a) to make orders necessary or appropriate for carrying out the provisions of the statute.[57] Accordingly, if debtors represent that, in the exercise of their business judgment, selective payment of 'critical vendors' will increase the prospects for successful reorganisation and will not prejudice other unsecured creditors, courts in the leading venues have broad discretion to acquiesce regardless of the impact on distributional priorities.[58]

However, there are two limitations to critical vendor orders as a vehicle for selective and differential treatment. First, the mechanism only applies to vendors and yet we have seen, in our examination of selective and differential treatment in a UK context, that the debtor may wish to single out many unsecured creditors who cannot accurately be described as vendors. Secondly, and crucially, while the reported cases,[59] and scholarship,[60] suggest that bankruptcy courts have been nodding through applications for critical vendor orders, experience in the court room and written transcripts tells a different story. We understand that bankruptcy judges in popular restructuring venues are increasingly questioning debtors' witnesses extensively on the issues of whether designated vendors are genuinely necessary for the successful reorganisation and whether the favourable treatment of critical vendors will prejudice other unsecured creditors, which suggests that there is heightened scrutiny of debtors' business judgment in practice. Indeed, the unease which some bankruptcy judges feel with critical vendor orders, and the risks of significant inquiry, emerge clearly

57 *In re Ionosphere Clubs, Inc* 98 BR 174, 175 (Bkrtcy. S.D.N.Y. 1989).

58 See for example *In re Windstream Holdings Inc* 614 BR 441, 451-453 (S.D.N.Y. 2020) (*Windstream*) (pointing out that bankruptcy courts routinely rely on debtors' representations and business judgment to identify critical vendors); *Czyzewski* v *Jevic Holding Corp* 137 S Ct 973, 985 (2017) (suggesting in *dicta* that priority-violating distributions such as payment of critical vendors are justified if they enable a successful reorganisation that will make disfavoured creditors better off in reorganisation than in liquidation).

59 *Windstream ibid*.

60 See, for example, Buccola, n 6 above, 17 stating that 'Debtors routinely file critical vendor motions, and courts routinely grant them.'

from the transcript in *In re Westinghouse Electric Company LLC*.[61] This means that even if the application is ultimately successful, a debtor seeking a critical vendor order faces the very real threat of serious inquiry (and the evidential burdens which accompany such an inquiry). Once again, this may incentivise a debtor to refrain from seeking a blanket designation of all unsecured creditors who could be classified as vendors as 'critical'.

This leaves one last mechanism for selective and differential treatment in the case: the executory contract regime. The US Bankruptcy Code does not define 'executory contract' and much ink has been spilled on the question of what the appropriate test should be.[62] We treat any contract in which performance remains outstanding to some extent by both parties to the contract as 'executory',[63] including unexpired leases which are explicitly within the scope of section 365. Section 365 permits the debtor-in-possession[64] to 'assume' the executory contract or to 'reject' it. If the debtor-in-possession assumes the contract, then all outstanding defaults must be cured, adequate assurance that the debtor will continue to perform must be forthcoming, and ongoing liabilities are payable with administrative priority. Thus, the contractual counterparty is likely to be kept whole. But if the executory contract is rejected, rejection is treated as a breach of contract immediately preceding the commencement of the chapter 11 case,[65] and the counterparty has a general unsecured claim for damages which can be compromised in the reorganisation plan,[66] subject only to an administrative expense claim for certain benefits which the estate received under the contract after commencement of the case and before rejection.[67] Section 365 thus authorises the debtor-in-possession to choose between two alternative treatments (performance or breach) with a view to maximising the estate.

There is no statutory right to rewrite an executory contract or unexpired lease in US chapter 11. However, debtors frequently use the threat of rejection to modify the contract terms,[68] and a counterparty or landlord may have lit-

61 First day transcript *In re Westinghouse Electric Company LLC* Case No 17-10751 (Bkrtcy. S.D.N.Y. 2017).

62 For useful summaries see American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11 2012-2014: Final Report and Recommendations* 112-115, Jay L. Westbrook and Kelsi Stayart White, 'The Demystification of Contracts in Bankruptcy' (2017) 91 Am Bankr LJ 481.

63 See for example *In re Penn Traffic Co*. 524 F.3d 373, 379 (2nd Cir 2008) and, generally, Westbrook and White, *ibid*.

64 On filing a voluntary chapter 11 case, the debtor becomes a debtor-in-possession: see 11 USC §§ 1101(1), 1107(a).

65 11 USC § 365(g) ('the rejection of an executory contract or unexpired lease of the debtor constitutes a breach …').

66 If the claim relates to termination of a real property lease, 11 USC § 502(b)(6) provides that damages are capped at the greater of one year's rent or the rent for 15 per cent, not to exceed three years, of the remaining term of the lease.

67 Strictly, the debtor-in-possession is obliged to meet the debtor's liabilities under the relevant contract or lease until it is assumed or rejected: 11 USC § 365(d)(3)(A). To the extent that the debtor-in-possession fails to perform post-petition obligations that accrue due before assumption or rejection the counterparty will usually be granted a high ranking administrative claim: 11 USC § 503(b)(1).

68 Josiah M. Daniel III, 'Lawyering on Behalf of the Non-Debtor Party in Anticipation, and During the Course, of an Executory Contract Counterparty's Chapter 11 Bankruptcy Case' (2014) 14 Houston Bus & Tax LJ 230, 251.

tle commercial choice if the alternative is rejection, and the counterparty will struggle to replace the debtor as a source of supply, or the landlord will struggle to relet the premises. Thus, different modifications may be agreed with different counterparties or landlords depending on variables such as relative bargaining power, reinforcing the unequal treatment between them.

The debtor-in-possession's decision to assume or reject is subject to court approval. Approval may be sought in the form of a noticed motion for assumption or rejection, or may be dealt with through the plan, but in either case the court's lens is focused narrowly on the contract in question. Moreover, most courts defer to debtor choice, and by extension, to the debtor's assessment of the expected benefit to the estate that will accrue from that choice. As Jason Kilborn puts it, '… only in the rarest of exceptional cases would the court be expected to refuse to confirm the trustee's or DIP's proposed decision on assumption or rejection'.[69] Indeed, Kilborn suggests that the threshold is as high as demanding a finding that the debtor's decision is 'entirely irrational' or 'taken in bad faith'.[70] The case law bears Kilborn out. Courts use a business judgment standard commonly expressed in terms that the court exercises a limited oversight function and will not second guess a debtor's decision to assume or reject its executory contracts absent a showing of bad faith, whim, or caprice.[71] Thus, if the debtor's business judgment is that the decision will benefit the estate, the court will invariably approve subject, in the case of assumption, to the debtor complying with the additional formal requirements to cure and assure.[72] The practical result is similar where amendments have been agreed. Josiah Daniel goes so far as to state that, '[i]f the debtor and non-debtor agree on amendment of the terms in the context of assumption, the court will almost always approve.'[73] In short, virtually all the power to sort among contracts to 'decide which ones it would be beneficial to adhere to and which ones it would be beneficial to reject' lies with the debtor.[74] Moreover, courts regard motions for approval of the assumption or rejection decision as summary proceedings 'intended to efficiently review the trustee's or debtor's decision to adhere to or reject a particular contract in the course of the swift administration of the

69 Jason Kilborn, 'National Report for the United States' in Denis Faber, Niels Vermunt, Jason Kilborn and Kathleen Van Der Linde (eds), *Treatment of Contracts in Insolvency* (Oxford: OUP, 2013) 515.

70 *ibid*.

71 See for example *In re Trans World Airlines, Inc* 261 BR 103, 121 (Bkrtcy. D.Del. 2001) (airline entitled to reject discounted ticket agreement with counterparty notwithstanding debtor's pre-petition waiver of its §365 rights where deference to the debtor was appropriate in the absence of bad faith or improper insider benefit); *Agarwal* v *Pomona Valley Med Group, Inc* 476 F 3d 665 (9th Cir. 2007) (holding that courts are no more equipped to make subjective business decisions for insolvent businesses than they are for solvent businesses). There is heightened scrutiny in limited contexts in which a powerful public interest is implicated: see for example *National Labor Relations Board* v *Bildisco and Bildisco* 465 US 513, 526 (1984), subsequently codified in 11 USC § 1113 (collective bargaining agreements); *In re Mirant Corp* 378 F 3d 511, 524-526 (5th Cir. 2004) (wholesale electricity purchase agreements). On the distinction between decisions in chapter 11 cases that call for *business* as opposed to *legal* judgment see further 7 Collier on Bankruptcy P 1108.07.

72 11 USC §365(b).

73 Daniel, n 68 above, 251.

74 *In re Orion Pictures Corp* 4 F 3d 1095, 1098 (2nd Cir 1993).

bankruptcy estate.'[75] And if the debtor has effectively used the threat of rejection to motivate bargaining, the court is likely to adopt a similar approach to a motion for assumption of an amended contract. At first glance, therefore, the executory contract regime appears to be a particularly powerful tool for selective and differential treatment, given that the decision is left to the debtor's business judgment and there is no prospect of intensive court scrutiny. If a contract or lease counterparty objects, the debtor's decision in relation to the contract or lease in question will be the subject of light touch, individual review. In the absence of objection, the court's approval will follow as a matter of course, consistent with the adversarial nature of the federal bankruptcy system. There will be no further review, and no consideration of the collective destiny of creditors impaired in this manner.

The foregoing analysis is, however, subject to an important caveat. In many cases the executory contract regime engages both the debtor and the counterparty or landlord in a highly uncertain game of chicken. The counterparty or landlord must assess whether the debtor is willing to reject the contract or lease, while the debtor must assess whether the counterparty or landlord is willing to accept rejection and damages rather than consent to amended terms. Both parties must therefore assess whether it is in their strategic interest to cooperate where it is hard to ascertain how the other might be expected to behave. We suggest that this characterisation of the executory contract regime limits its attractiveness as a mechanism for selective or differential treatment, even absent court review of the debtor's decision-making process. If the debtor presses rejection in circumstances where it is not prepared to follow through, the landlord may call its bluff leading to an expensive assumption liability. Conversely, if the landlord holds out for better terms in unfavourable market conditions, the debtor may call its bluff leading to rejection, in which case the debtor may lose a valuable contract or location. Thus, there is an incentive for the debtor to honestly reveal terms which it can afford, at least where rejection is an unattractive possibility.

When we consider the treatment of executory contracts and unexpired leases in UK restructuring law, we find a different approach which, on closer analysis, involves a different game of chicken with different strategic implications and, perhaps, a heightened need for court review. There is no express right of assumption or rejection of executory contracts or unexpired leases in any of the UK's restructuring procedures. And the debtor cannot unilaterally 'reject' (or, in UK parlance, surrender) an unexpired lease because a lease is a property right.[76] However, a functionally similar result can be achieved, in the case of Part 26 schemes, Part 26A restructuring plans, and CVAs (considered further below) by amending the counterparty's contractual rights in the scheme, restructuring plan, or CVA.[77] While the debtor cannot unilaterally terminate a lease, a lease can be modified to reduce rental obligations to zero in the scheme, plan, or CVA (although, if the landlord does not exercise a right to terminate,

75 *ibid*.
76 *Re Instant Cash Loans Ltd* [2019] EWHC 2795 (Ch).
77 Although it is not possible to impose new obligations. See *Re Apcoa Parking Holdings GmbH and others* [2014] EWHC 3849 (Ch); [2015] 4 All ER 572 at [133]-[167].

the debtor will remain responsible for business rates).[78] In deciding whether to sanction a Part 26A restructuring plan over the objections of a dissenting class the principal question which the court must ask itself is whether that class is worse off under the plan than it would be in the event of the 'relevant alternative'.[79] The 'relevant alternative' is what the court considers would be likely to happen if the plan were not sanctioned.[80] The debtor's treatment of executory contracts and unexpired leases will be reviewed against this 'relevant alternative' when the court is asked to sanction the Part 26A restructuring plan. In reviewing how the plan treats counterparties and landlords, the court is not limited to establishing a single, enterprise value for the firm and then benchmarking the plan treatment against how that value would be distributed down the creditor 'waterfall priority scheme',[81] as happens in US chapter 11. Instead, the debtor will need to show how the counterparty or landlord would have fared in the wider circumstances of the 'relevant alternative': for example, if a purchaser for the business would have been likely to take over the contract or lease. Thus, the debtor's decision of whether to continue, or achieve the functionally similar result of rejecting, a contract or lease will be subject to review against the wider circumstances of the 'relevant alternative'. In other words, the counterparty or landlord has stronger, more widely contextualised grounds to object to the debtor's treatment of an executory contract or unexpired lease in the UK than in US chapter 11.

A further, crucially important, distinction between the US chapter 11 executory contract regime and the functionally equivalent regime in Part 26A is that a Part 26A restructuring plan can be imposed on a dissenting class which varies the terms of the creditors' contracts in that class. The *Virgin Active* case[82] provides a good illustration. In that case compromised landlords were divided into five classes: classes A-E. Each class was offered a different package of rights in the restructuring plan, ranging from full payment of contractual arrears, and amended payment terms, to compromised and deferred rent, or no rent at all and a small, one-off payment. Only the class A landlords supported the plan, and yet the court imposed the plan on the dissenting classes via the cross-class cram down power. Thus, the terms of the leases of the Class B-E landlords were modified without landlord consent. We will see, when we turn to CVAs, that the courts have recently insisted that if the terms of unexpired leases are modified, the landlord must be provided with a right of termination and that the terms offered upon exercise of that termination right must be at least as beneficial as the relevant alternative.[83] In our view, this ought to apply in Part 26A restructuring plans as well, so that in practice the debtor cannot impose

78 Thus, the result is functionally similar, but not identical, to rejection of an unexpired lease in US chapter 11 as the debtor will continue to incur liabilities under the lease. A landlord who cannot re-let the premises may leave the debtor paying unoccupied business rates and may not exercise its right to terminate the lease.

79 Companies Act 2006, Part 26A, s 901G(4).

80 *ibid*.

81 Buccola, n 6 above, 16.

82 *Virgin Active* n 48 above.

83 *Lazari Properties 2 Ltd et al* v *New Look Retailers Ltd et al* [2021] EWHC 1209; [2021] Bus LR 915 (*New Look*) at [222]. In CVAs, the judicially developed test is sometimes expressed as whether the terms offered are at least as beneficial as those the landlord would obtain in the 'relevant vertical

modified terms if the landlord is willing to terminate instead.[84] If the landlord does terminate, whereas the US Bankruptcy Code provides the formula for a landlords' damages claim, in the UK the question will be the measure of damage which the landlord would have been entitled to in the relevant alternative. In the UK regime, the debtor and the counterparty or landlord must, once again, assess each other's incentive to terminate. However, under UK law the power to terminate rests with the landlord, not the debtor, and absent termination, the landlord will be faced with modified terms. By contrast, in US chapter 11, the debtor who blinks first and assumes rather than rejects, is held to the original terms going forward. It is outside the scope of this article to attempt a detailed review of the different strategic behaviours which may follow from these different games of chicken. But our initial reaction is that more power lies with the debtor in the UK regime, suggesting a heightened need for court review of the debtor's decision-making against the relevant alternative. This is borne out further in our analysis of the final UK restructuring procedure – the CVA – to which we now turn.

## CVAs

CVAs differ in three important respects from the other procedures considered thus far. First, they cannot be used to compromise the claims of secured or preferential creditors without their consent, and so they are used invariably to achieve a compromise between a company and its unsecured creditors.[85] This contrasts with schemes of arrangement, Part 26A restructuring plans and chapter 11, all of which can be used to reduce the voting threshold required for a restructuring of secured debt. Secondly, the CVA is predominantly an out of court procedure: the court only becomes involved in the event of a creditor challenge. This out of court feature contrasts sharply with the court supervised US chapter 11, and with both the scheme of arrangement and the Part 26A restructuring plan procedure. Because the procedure is largely conducted

comparator': *ibid* at [218]. Nonetheless, the approach under either the 'relevant alternative' in Part 26A and 'the relevant vertical comparator' is conceptually the same, albeit it requires some modification to reflect the fact that creditors vote as a single class in a CVA: *ibid* at [192]-[199] and text following nn 85 and 93 below.

84 It is also worth noting that the new ban on so-called ipso facto clauses introduced in the Insolvency Act 1986, s 233B by the CIGA relates to 'contracts for the supply of goods or services.' As a lease primarily creates a proprietary interest, most unexpired leases will fall outside the restriction. This is reflected in para 231 of the Explanatory Notes to the CIGA which states that, 'Agreements such as licenses, property leases and agreements for the sale of land or property are not characterised as contracts for the supply of goods and services, therefore they are not covered by the provisions of s 233B. A sophisticated lease/licence/sale agreement may contain an element of provision for the supply of goods and services; this element would be covered by s 233B. The remainder of the lease/licence/sale agreement will not be affected'. This means that it would also be open to a landlord in the UK to exercise a termination right in the lease triggered by its tenant's insolvency. This contrasts with the equivalent US ban on ipso facto clauses found in 11 USC § 365(e) which expressly prevents a landlord from terminating or modifying an unexpired lease because of the insolvency or financial condition of, or the opening of chapter 11 proceedings for, its tenant.

85 Insolvency Act 1986, s 4(3) and s 4(4).

out of court, an insolvency practitioner is appointed who acts as a 'nominee' before the proposal is approved and as 'supervisor' of the arrangement after approval. The insolvency practitioner is conceived of as the independent monitor of the arrangement in the legislation: the nominee's principal role is to report to the court on whether, in their opinion, the proposed voluntary arrangement has a reasonable prospect of being approved and whether it should be put to the company's shareholders and creditors for approval. In practice, however, the insolvency practitioner will advise the debtor on how to resolve its financial difficulties and will be intimately involved in determining how best to address those difficulties and whether the CVA might offer a solution. Finally, all creditors vote in a CVA, and creditors vote as a single class. This contrasts with the scheme of arrangement in which the company is free to select which creditors to include in the scheme and with the Part 26A restructuring plan in which only affected creditors vote. And single class voting contrasts sharply with voting in classes which is a core feature of US chapter 11, UK schemes of arrangement and Part 26A restructuring plans.

Notwithstanding these differences, the courts have rejected challenges to CVAs which leave some of the (voting) creditors unimpaired or barely impaired in the proposal and which offer different terms to impaired creditors of otherwise equal rank.[86] An impaired creditor could seek to challenge such a CVA on one of two grounds: that it unfairly prejudices its interests or that there was a material irregularity in the vote.[87] Recent cases have confirmed that a CVA which selects some voting creditors to absorb the loss, and which provides for differential treatment of impaired creditors is not automatically unfairly prejudicial.[88] In *New Look*, Zacaroli J identified the need to consider questions of allocation between impaired and unimpaired creditors and the nature, extent and justification for differential treatment in considering the question of unfair prejudice.[89] In *Debenhams*, Norris J found the case for unfairness unconvincing where landlords suffered a compromise while trade creditors were unimpaired. In its evidence, the company focused on 'contagion risk': attempts to compromise trade creditors leading to concerns over supply; tighter credit terms; poor customer experience; and brand damage.[90] Counsel for the landlords argued that many of the unimpaired creditors were not trade creditors who were crucial to the business.[91] It is worth quoting Norris J's response in full:

> … in my judgment both the directors and the nominees were entitled to look at the matter in the round having regard to the likely reaction of the 1600 suppliers of goods and services, rather than to single out a small number of individual suppliers for separate treatment where such separate treatment would make a wholly immaterial contribution to the outcome. As [a witness] indicated in cross-examination, the

86 See, in particular, *Discovery (Northampton) Ltd* v *Debenhams Retail Ltd* [2019] EWHC 2441 (Ch); [2020] BCC 9 (*Debenhams*) and *New Look* n 83 above.
87 Insolvency Act 1986, s 6.
88 *ibid*.
89 *New Look* n 83 above at [192]-[199].
90 *Debenhams Retail* n 86 above at [106].
91 *ibid* at [107] – these creditors included a minicab firm, a firm of accountants, and a firm of solicitors.

> question was not whether their supplies were critical to the business but whether their treatment was critical to the success of the CVA.[92]

Norris J clearly recognises the dangers in widening the 'circle of cooperation', not only in terms of increased cost and time, but also in terms of destabilising an already fragile situation. And perhaps the crucial point is the finding that '… such separate treatment would make a wholly immaterial contribution to the outcome'. Reading between the lines, Norris J is concerned that efforts to share the loss more widely might increase both direct and indirect costs for little purpose.

Just as we saw in the *Virgin Active* Part 26A restructuring plan, CVAs can also be used to modify the terms of executory contracts or unexpired leases. The result may be that counterparties or landlords of otherwise equal rank suffer different modifications to their contracts or leases in a CVA proposal. To date, this kind of differentiation has been primarily tested in CVAs designed to reduce leasehold liabilities. In *New Look*, Zacaroli J put much emphasis on the landlords' right to terminate the lease if they did not consent to the amendments on offer.[93] However, we have already suggested that the UK executory contract regime leaves more power with the debtor than the US equivalent, and that, as a result, there is a need for the court to concern itself with modifications which are offered in the restructuring plan compared with the terms which the counterparty or landlord would expect to obtain in the event of the relevant alternative. We suggest that this need for court review of proposed modifications benchmarked against the relevant alternative applies equally in the case of a CVA. We do not consider the termination right to be a complete answer, because the counterparty or landlord may be able to show that in the event of the 'relevant comparator' (as the test is usually expressed in the context of a CVA) it would have achieved more favourable modified terms and would not have needed to consent to termination and a heavily compromised damages claim. We understand the attraction for the courts in avoiding such a detailed evidential inquiry. Yet, consistent with our emerging argument, we consider the threat of such an intensive inquiry is important to prevent the debtor from offering terms which neither reflect its capacity to perform nor the market.

Aside from contract and lease modifications, there are otherwise considerable similarities between the approach of the courts when reviewing selective and differential treatment for unfair prejudice in CVA cases and the approach of the courts in Part 26 schemes of arrangement and Part 26A restructuring plans. Yet, as we have seen, there will only be court review if a challenge is mounted, while creditors may be sceptical about the independence of the insolvency practitioner in determining which creditors to impair and which to leave unimpaired, or barely impaired, in the CVA or in settling differential terms. This scepticism is borne out by Zacaroli J's decision in *Carraway Guildford (Nominee A) Ltd* v *Regis UK Ltd* to revoke the CVA's approval on the ground that the

92 *ibid*.
93 *New Look* n 83 above at [222].

company's shareholder should not have been categorised as a 'critical creditor', and the light it sheds on the attention which nominees pay to this issue.[94]

Moreover, the courts appear to see their role differently in a CVA when compared with the other procedures. In the context of schemes of arrangement and Part 26A restructuring plans, the courts have declined to make adverse costs orders against creditors who raise genuine and properly articulated objections.[95] This is on the basis that the opposing creditor may be assisting the court as it navigates the decision to approve the scheme or plan. Indeed, if the objection is raised in good time and is helpful and focused, the court may well order the debtor to meet the objector's costs.[96] Accordingly, as we have maintained, the process for sanction of schemes and restructuring plans is less adversarial, arguably even quasi-inquisitorial. However, the courts have not extended this less adversarial approach to CVAs.[97]

In a hearing related solely to costs in the context of the *Debenhams* CVA, Norris J distinguished sanction of a scheme of arrangement from the usual case in litigation in which there would be a 'successful party' and an 'unsuccessful party'. He contrasted scheme sanction with the position in a CVA in which the creditors are bound by the CVA but entitled to raise a challenge. In this instance, he stated, 'There will in the end be a "successful party" and an "unsuccessful party"' with the result that the general (loser pays) rule is 'capable of application".[98] In the end, 'A challenge to a CVA is simply adversarial litigation between parties.'[99] Thus, a creditor who wishes to challenge the selection choices which have been made in a CVA before the courts runs a significant costs risk in doing so. This contrasts unfavourably with the default rule in US chapter 11 that costs lie where they fall; acts as a powerful disincentive to challenge; and thus undermines the effectiveness of the threat of court review in constraining the debtor's selective and differential strategy in a CVA.

Moreover, the need for careful review is arguably heightened in a CVA context because the statutory majority may be achieved by virtue of the votes of unimpaired or barely impaired creditors: creditors vote as a single class in a CVA and creditors who are unimpaired or barely impaired by the proposal nonetheless vote on the arrangement. For a CVA to be approved, support is required from 75 per cent of creditors by value of those who vote, at least 50 per cent of whom must be unconnected with the company.[100] Thus, if a significant number of unimpaired creditors support the CVA, it may be approved even if the

94 *Carraway Guildford (Nominee A) Ltd* v *Regis UK Ltd* [2021] EWHC 1294 (Ch); [2022] 1 BCLC 709.
95 *Re Stronghold Insurance Company Ltd* [2018] EWHC 2909 (Ch); [2019] 2 BCLC 11 at [145]; *Re Ophir Energy Plc* [2019] EWHC 1278 (Ch) at [39]; *Re Inmarsat plc* [2020] EWHC 776 (Ch); [2021] 1 BCLC 446 at [12]-[16].
96 See the discussion in *Re Inmarsat plc ibid* at [12]-[16], [24].
97 *Discovery (Northampton) Ltd* v *Debenhams Retail Ltd* [2020] EWHC 1430 (Ch); [2020] BPIR 1378.
98 *ibid* at [13].
99 *ibid* at [15].
100 The Insolvency (England and Wales) Rules 2016, SI 2016/1024, r 15.34.

75 per cent threshold would never have been achieved had the impaired creditors voted separately.[101]

The composition of the majority was one of the grounds of challenge to the *New Look* CVA.[102] In that case the statutory majority was achieved by virtue of the votes of holders of senior secured notes (SSNs) who had agreed to release their secured debt claim in return for equity in a separate scheme of arrangement which the court found to be closely connected to the CVA.[103] Secured creditors vote in a CVA in respect of the unsecured portion of their debt.[104] In *New Look*, Zacaroli J determined that the holders of the SSNs were impaired by the restructuring as a whole and were being offered nothing in respect of the unsecured portion of their debt in the CVA.[105] Thus, this was not a case in which the statutory majority was achieved by virtue of the votes of a class which was materially better off than the other, compromised creditors. The votes of ordinary, unimpaired, unsecured creditors were also counted in the statutory majority. However, even though their votes (together with those of some unimpaired landlords) were 'substantial', they were not enough in aggregate to have had a material effect on the vote. In short, even if their votes were discounted completely, the statutory majority would still have been achieved.[106]

Thus, Zacaroli J distinguishes *New Look* from cases in which the statutory majority is achieved by virtue of the votes of ordinary, unsecured creditors whose claims are to be paid in full but who would have received only a small distribution had the CVA not been approved, and an insolvency proceeding followed instead. In this instance, even if there is an objective justification for paying the ordinary, unsecured creditors in full, Zacaroli J suggests he would wish to investigate the fairness of the arrangement in detail. Notably, this may include considering whether there might be another, fairer arrangement.[107] Overall, what matters is the nature and extent of the different treatment, the justification for that treatment, and its impact on the outcome of the meeting vote.[108] However, and crucially, there will only be a court review of selective and differential treatment in a CVA in the event of a challenge. And the risk of a costs order acts as a powerful disincentive to a challenge. This means that case law may take some time to develop and, even when it does, the extent to which it feeds into changes in insolvency practitioner behaviour may be uncertain.

To this point, we have tentatively suggested that it is not sufficient merely to identify a menu of relevant criteria for legitimate selective or differential treatment – in most cases the debtor will also need to fear independent review of its plan against these relevant criteria to protect adequately against the risk of abuse. Overall, we conclude that the UK approach is inclined towards

101 A meeting of shareholders is also held to approve the proposal, at which a simple majority is required (*ibid*, r 2.36). This meeting cannot, however, override the creditors' decision although an application to court can be made in this event.
102 *New Look* n 83 above at [64], [116]-[154].
103 *ibid* at [14], [242]-[248].
104 Insolvency Rules, n 100 above, r 15.31(4) and (5).
105 *New Look*, n 83 above, at [261].
106 *ibid* at [269].
107 *ibid* at [147], [193]-[196].
108 *ibid* at [197].

holistic reviews of the treatment of impaired and unimpaired creditors in a quasi-inquisitorial fashion. We find that, in general, the threat of review in a US context emerges in an adversarial context, although we find that this also fulfils the function of constraining debtor behaviour against the threat of review, other than where the debtor is confident of achieving a consensual plan. Thus, we have suggested that the principal area for attention in the US is whether there should be a more quasi-inquisitorial approach in cases where debtors propose quasi-consensual plans. However, our characterisation of the UK approach as quasi-inquisitorial does not hold when we turn to the UK CVA. In this instance, there may be no court review at all and, where there is a court review, the approach is considerably more adversarial. We doubt whether review by an insolvency practitioner can currently be regarded as functionally equivalent to a holistic, quasi-inquisitorial review by the court. Thus, as we will see in the final part, our principal area of concern in a UK context is the CVA.

## IMPLICATIONS OF THE SELECTIVE RESTRUCTURING STRATEGY

One of our ambitions in this article is to formulate a menu of relevant criteria for evaluating a selective and differential restructuring strategy. However, we also argue that the threat of independent review of the debtor's restructuring plan against these relevant criteria is of crucial importance in constraining illegitimate use of the mechanisms which are available to achieve such a strategy. We make this argument because significant problems follow if the debtor's standards of allocation remain hidden. For this part of our analysis we draw on two literatures: literature on how decisions are made about the allocation of scarce resources (notably the work of Calabresi and Bobbitt),[109] and literature on the theory of decision procedures.[110] Following Calabresi and Bobbitt, we focus on cases in which the debtor decides which creditors will absorb loss and which will be kept whole, and differentiates between impaired creditors of otherwise equal rank, where the standards which the debtor is applying to make these choices are 'unclear and decisions highly individualized or aresponsible'.[111] 'Individualized' means, in this context, that precise loss allocation decisions made in any specific case are highly fact-sensitive, while 'aresponsible' means that the debtor is not held to standards of loss allocation which can be clearly described and applied.[112] Two types of problem emerge from this

109 Guido Calabresi and Philip Bobbitt, *Tragic Choices: The Conflicts Society Confronts in the Allocation of Tragically Scarce Resources* (New York, NY: W.W. Norton & Company, 1978).

110 This label derives from Amartya Sen, *Collective Choice and Social Welfare* (London: Penguin, expanded edition, 2017) vii.

111 Calabresi and Bobbitt, n 109 above, 132.

112 For simplicity, we refer simply to the debtor. However, we note that the issues which we discuss may be heightened where the debtor is influenced, in deciding how to allocate loss, by powerful financial creditors. For the increasing influence of financial creditors in governance decisions in US chapter 11, see Kenneth Ayotte and Jared A. Ellias, 'Bankruptcy Process for Sale' (2022) 39 Yale J on Reg 1. As one of the anonymous reviewers highlighted, there are also concerns that financial creditors increasingly dictate treatment of landlords to debtors in the UK as a condition of a wider financial restructuring or continued support.

process of 'individualized or aresponsible' loss allocation: one procedural and one substantive.

The procedural problem is captured by Calabresi and Bobbitt: 'The Kafkaeseque costs of being in a process without knowing how to help oneself … typical of all aresponsible decision-making procedures …'[113]

The substantive problem is that what may be being hidden are choices to prefer creditors not for the purposes of achieving a sustainable restructuring but rather because the preferred creditors are related to the debtor, or because the debtor simply liked them more, or for other reasons which appear far-removed from any core restructuring and insolvency principle. In other words, because the standards which determined the allocation of loss are hidden, the creditors who are disfavoured suspect foul play which, in turn, undermines the legitimacy of the process and there is a heightened risk of abuse. We saw an example of this in the previous part, where Zacaroli J (rightly) revoked a CVA which had treated a shareholder as a critical creditor.

At the same time, it is not possible to capture completely, in a menu of criteria for judging loss allocation choices, all the nuances which may be relevant in assessing a specific case. For example, we have seen that one criterion English judges have used in determining whether it is acceptable to leave certain creditors unimpaired is that the costs of filtering out suppliers who were not critical to the business and bringing them within the compromise would outweigh the benefits to the impaired creditors of doing so.[114] Thus, the criterion that the 'losers' would not be materially better off if the 'winners' were impaired is one of our relevant criteria for assessing the decision to leave specific creditors unimpaired in the plan. Suppose, however, that the relevant unimpaired creditors are junior bondholders, and that the company concludes that the threat of litigation, and the attendant costs, outweigh the benefits to other impaired creditors in bringing the bondholders within the compromise. Our intuition, assuming the company expected to win the litigation and that the value of the junior bond which would be compromised is significant, is that this would not meet our relevant criteria for leaving the junior bondholders unimpaired. We accept, however, that this is not immediately apparent so that the decision needs to be subject to the supervision of an expert, independent body which can interrogate the case-specific context in which the relevant criterion is said to be met.[115]

Thus, we suggest that both criteria for the allocation process, and an independent body which can review the process against these criteria, are needed. This will help to transform the process from an individualised and aresponsible decision-making process into one in which there is a responsible and accountable decision-making body, preventing the debtor from exploiting a seemingly open-ended situation to prefer some creditors over others for reasons far removed from any acceptable insolvency and restructuring principle. And we suggest that various criteria can be extracted from our comparative review of

113 Calabresi and Bobbitt, n 109 above, 132.
114 Text accompanying nn 86-92 above.
115 We are grateful to Vincent Buccola, both for the example and for pushing us on this point.

the mechanisms for selection and differentiation between creditors in the UK and the US to aid the review.

First, we saw that the concern (reflected in Delaney's work) that the debtor may be using corporate restructuring law to wash off liabilities owed to certain stakeholders for the benefit of other stakeholders is much less acute if, absent the restructuring, the debtor will progress down the demise curve and enter a situation of general default. Our first criterion, then, is that the debtor must be resorting to the procedure to restructure. We particularly approve of the threshold financial conditions in Part 26A restructuring plans and of the ability to dismiss a US chapter 11 case where the debtor has no valid reorganisational purpose, as these serve as formal constraints on what would otherwise be aresponsible behaviour. We also note that the requirement to identify the counterfactual, or relevant alternative, or relevant comparator to a UK scheme of arrangement, Part 26A restructuring plan, or CVA provides a powerful mechanism to guard against premature and opportunistic abandonment of selected liabilities.

Secondly, the debtor should anticipate that it may be required to justify its decision to leave certain classes of creditor unimpaired either because those creditors are critical to the success of the restructuring or because, even if they were included in the restructuring, this would not make a material difference to the losses which the impaired creditors suffer. This is broadly the position in UK Part 26 schemes of arrangement, Part 26A restructuring plan procedures, and, where court review happens, CVAs, although, as we have seen, the extent to which this criterion is reviewed is currently of variable intensity. We approve of the courts' increasingly inquisitorial approach in Part 26A restructuring plans, suggesting that review should happen even when a plan is quasi-consensual and no specific objection on these issues is raised. For the most part, we conclude that the threat of review of non-consensual chapter 11 plans also does the job of constraining debtor behaviour in selecting and differentiating between creditors. The area we highlight for further consideration is where the debtor is confident that it will achieve a consensual plan. In this case, the debtor appears to have much less to fear in terms of court review, while in reality a significant number of creditors may oppose the plan.

Thirdly, we consider that a different mechanism operates to constrain behaviour in the US executory contract regime and, while this has some similarities to the mechanism for handling contract and lease modifications in the UK restructuring procedures, we suggest that more power rests with the debtor in this context in the UK than in the US. As a result, we contend that where an executory contract or an unexpired lease is modified in a Part 26A restructuring plan or CVA, a termination right should not be a complete answer to the fairness of the terms on offer, particularly where a damages claim may be heavily diluted in the plan. Instead, we consider it should be open to the counterparty or landlord to argue that the terms on offer are less favourable than those which would have been on offer in the event of the relevant alternative to the restructuring plan or relevant comparator to the CVA.

Fourthly, the votes of unimpaired creditors should not be used to approve the restructuring in single class voting, unless they are small in number and value,

a conclusion which holds even if there is a justifiable reason for excluding the unimpaired creditors from the compromise

And finally, we are particularly concerned about the UK CVA where there is limited or no court review of a restructuring plan. At the very least, we suggest that rigorous regulatory requirements should be imposed on the insolvency practitioner to assess the arrangement against relevant criteria for selective and differential treatment and to report on these issues to creditors. We suggest regulatory innovation both because we recognise the challenges of legislative reform and because we recognise the transaction cost implications of increased court involvement.

We can now assess the UK and US procedures and mechanisms which we have analysed against this menu of relevant criteria, as follows:
The table enables us to identify how UK restructuring procedures might better align with our relevant criteria, and how they compare with the approach in US chapter 11. We find that, for the most part, both schemes of arrangement and Part 26A restructuring plans align well with the criteria. Specifically, we find the UK courts step back to consider the overall shape of the plan in terms of its implications for unimpaired and impaired creditors, and its treatment of the impaired creditors among themselves, in a quasi-inquisitorial fashion. We contrast this with US chapter 11 where we consider that the threat of inquiry is real in the event of a non-consensual plan but remain concerned about the scope for illegitimate use of tools to select and differentiate between creditors in quasi-consensual plans.

When we turn to CVAs we find a firmly adversarial approach in the UK so that, absent a specific challenge, there will be no review of either the selective strategy or differentiation between impaired creditors by the court. In pursuing a challenge, the opposing creditor faces a significant adverse costs risk, so that the debtor may not fear a court inquiry. And we find no formal condition for entry into the procedure. This gives rise to the concern that the debtor may resort to the procedure to wash off debts creating too much unfair value for the remaining stakeholders. The insolvency practitioner ought to act as a gatekeeper to prevent this, but we suggest that the role of the insolvency practitioner in the CVA, and their reporting obligations, would benefit from more granular detail so that a review which is more obviously independent and holistic is available for the creditor body. We suggest that these reporting requirements should include more specific discussion of the rationale for excluding creditors from the CVA and for modifying certain executory contracts or unexpired leases, using our relevant criteria as a guide. And we suggest that insolvency practitioners should not be permitted to recommend a CVA where the vote in favour is only to be secured by the votes of unimpaired creditors, unless those creditors are small in both number and value. We suggest that all these issues can be tackled by replacing Statement of Insolvency Practice (SIP) 3.2 (Company Voluntary Arrangements) with more detailed regulatory requirements. While SIPs do not have legislative force, breach exposes the insolvency practitioner to potentially serious regulatory sanction. Pragmatically, this heightens the incentives for the insolvency practitioner to act as a gatekeeper of the procedure for all creditors while avoiding the need for legislative intervention, so that meaning-

| Relevant criteria | Schemes of arrangement | Pt 26A restructuring plans | CVAs | Chapter 11 |
|---|---|---|---|---|
| Debtor resorting to procedure to restructure | No formal condition | Financial conditions | No formal condition | No formal condition but case can be dismissed if not filed in good faith for a valid reorganisational purpose |
| Where specific creditors are unimpaired either:<br>• Critical to success; or<br>• 'Losers' would not be materially better off if 'winners' were also impaired | General approach of court to excluded creditors | General approach of court to excluded creditors | General approach of court to excluded creditors but no court review absent creditor challenge | Where a class is designated as unimpaired or administrative convenience, debtor must defend against unfair discrimination and fair and equitable standards in the event of a non-consensual plan. Courts increasingly likely to inquire closely into designation of critical vendors along both these dimensions |
| Modifications are at least as favourable as those available to counterparty or landlord in the event of the alternative to the restructuring plan | Comparison with counterfactual | Comparison with 'relevant alternative' | No court review absent creditor challenge. Focus on termination right as opposed to modifications. | Requirement for creditor consent but debtor can reject |
| If creditors vote in a single class, unimpaired creditors should not secure the vote unless small in number and value | N/A | N/A | Dicta of Zacaroli J in *New Look* but no court review absent creditor challenge | N/A |




(2022) 0(0) MLR 1–29

ful reform is likely to be achieved more rapidly. And as a matter of principle, the approach focuses on developing the insolvency practitioner as the gatekeeper of the procedure which avoids the cost implications of more significant court involvement.

Finally, we note that different considerations may apply where specific types of creditors absorb the loss, such as tort creditors or employees. In the case of both groups, there may be an argument of 'absolute worthiness': whether an individual who has suffered a personal injury or an employee who will see their salary and benefits curtailed is sufficiently worthy that they should not be asked to bear the loss alone.[116] However, space does not permit consideration of this issue here. It will need to wait for another day.

## CONCLUSION

Modern corporate restructuring is more likely to be selective than collective. In other words, specific classes of creditor are likely to be chosen to absorb the loss while other creditors ride through the case unimpaired. Moreover, debtors may seek to differentiate between impaired creditors which would be of the same legal rank in corporate insolvency law's distributional order of priority. We suggest that there are many instances in which these twin phenomena of selectivity and differential treatment are legitimate, and we suggest a menu of relevant criteria for identifying these legitimate cases. We suggest that UK schemes of arrangement and Part 26A restructuring plans measure up quite well against our legitimising framework insofar as selectivity and differential treatment is concerned, and we suggest that the court's increasingly quasi-inquisitorial approach to these issues does much to constrain debtor behaviour. For the most part, we find that the threat of review of selective and differential treatment in a US chapter 11 plan incentivises the debtor to consider selective and differential treatment carefully, although we raise some concerns with quasi-consensual plans. We find a different mechanism operating in the executory contract regime and suggest that more power lies with the debtor in the equivalent regime in the UK, suggesting a need for heightened court inquiry. However, our most serious concern in a UK context is with the CVA where court review is not guaranteed and where courts adopt an adversarial stance. Thus, we suggest that the regulatory requirements for insolvency practitioners should be considerably strengthened in the CVA context, including requirements to provide more specific disclosure of the rationale for excluding creditors from the CVA and for modifying certain executory contracts or unexpired leases, using our relevant criteria as a guide.

116 We have adapted this idea of absolute worthiness from Calabresi and Bobbitt, n 109 above at [63]: 'Instead of being asked to allocate scarce resources among applicants on the basis of their worthiness relative to each other, the agency is asked to determine if a particular applicant is, in absolute terms, sufficiently worthy to be given the goods'.