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Kirkland Alert

English Court Crams Down Dissenting Landlords in Fitness First’s Restructuring Plan

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At a Glance

The English Court yesterday published its judgment approving Fitness First’s restructuring plan, notwithstanding a challenge from certain opposing landlords.

This judgment underlines the position — first established in the similar case of *Virgin Active* (see our *Alert*) — that creditors who are “out of the money” in the relevant alternative have no standing to object to the manner in which a restructuring plan allocates the benefits of the restructuring between stakeholders.

Fitness First’s plan involved a five-month “instalment plan” for a historic VAT liability owed to HMRC, which voted in favour of the plan. This contrasts to HMRC’s active opposition to three other recent restructuring plans which sought to impose haircuts on HMRC (see our *Alert* on Nasmyth and GAS’ restructuring plans, which the court declined to approve, and our *Alert* on Prezzo’s restructuring plan, which the court approved last week).

This plan was the first to compromise business rates payable to local authorities in respect of premises — a technique Kirkland pioneered in respect of company voluntary arrangements in *Homebase* (see our *Alert*) and which Prezzo also used in its restructuring plan (see our *Alert*).

Background

The principal terms of the restructuring plan were as follows.

Stakeholder	***Terms***	***Approval (by value, of those voting)***
Secured creditor (also 75% indirect shareholder)	• No haircut; term extended by 11 months (to 2028) and amendments comprising three-year interest waiver and cap on guarantee obligations	Approved (100%)
HMRC (secondary preferential creditor)	• Overdue VAT liability to be repaid in full in instalments over five months	Approved (100%)
Landlords, divided into six different classes[1]	• Varied across classes, from no rent reduction and full payment of rent arrears, with a switch to monthly rent (Class A) to full compromise in return for payment of basic restructuring plan return — namely, 120% of estimated return in administration alternative — within 12 months of the restructuring effective date (Class D) • Break rights granted (except Class A)	Class A unanimously approved Other five classes rejected (0-32% in favour)
General property creditors and business rates creditors[2]	• Compromised in full for payment of basic restructuring plan return (described above) — save that all business rates referable to 28-day period following restructuring effective date are to be paid in full[3]	Approved (99%)

A valuation of the business estimated value in the range of £4.5–7 million –– well below secured indebtedness of c.£18.7 million.

Shareholders were not included within, or compromised by, the restructuring plan. Shareholders had provided funding/credit support since 2020 (most recently in January 2023) but did not specifically contribute new value under the restructuring.

Trade creditors (including the plan company's parent in respect of head office employee claims and related liabilities) were also excluded from the plan, given the "critical" nature of their supplies/services and the cost and complexity of including them.

The plan was opposed by a "Class B1" landlord and separately by four "Class B2" landlords. The court granted a two-week adjournment in respect of the sanction hearing, upon application by the opposing landlords.

Judgment

Relevant alternative

Opposing landlords criticised the questionable nature of the company's "burning platform" / long stop date of 30 June, given the company's secured creditor was also a 75% indirect shareholder (i.e., the only reason the company was obliged to enter into a plan by that date was because the company had promised its shareholder that it would do so).

However, the court held that there was no real evidential basis that the company would be able to use a shareholder loan facility to tide it over its peak cash shortfalls and continue to trade (as certain landlords had contended). The court agreed with the company that the relevant alternative to the plan was an administration with an accelerated M&A process leading to a prepack sale.

Discretionary matters

Given the court's finding as to the correct relevant alternative, there was no issue as to the satisfaction of the two statutory requirements for binding a dissenting class (i.e., the "no worse off" test and the requirement for an "in the money" consenting class). Accordingly, the focus was on matters relevant to the exercise of the court's discretion.

Ground of Opposition	***Ruling***
The plan did not represent a "fair distribution of benefits", in part because the company's shareholders were not being compromised under the plan and a shareholder debt was treated as a critical creditor claim	• The opposing landlords were "out of the money" according to the unchallenged valuation evidence put forward by the company. • As stakeholders with no genuine economic interest in the company can be deprived of a vote on the plan altogether[4], their interests should not carry any real weight when the court comes to exercise its discretion. Out-of-the-money creditors "have no real entitlement to share in the restructuring surplus and cannot really sustain a complaint that it is all unfair"; their opposition to the plan can be overridden. • This test applies by reference to the plan company itself. The prospect of recovery from a third-party guarantor, for example, cannot affect whether a creditor is "in the money" vis-à-vis the plan company. • In this case, it was for the secured creditor, as the economic owner of the business, to determine how to divide up value/potential future benefits. • On the facts, continued payments to the company's shareholder (in respect of group administration/other services) did not undermine the fairness of the plan; the company's board had deemed such services as critical to trading and at least the bulk of such costs would be incurred by the company anyway if they were not provided by the shareholder. Further, given the objecting landlord was out of the money, its objections carried little weight.
Lack of engagement with landlords / lack of information	• Legitimate complaint could be made as to the lack of engagement with the landlords and the resistance to the provision of information. However, whilst the court considered that the company should have made more effort to engage with landlords and had sympathy with the landlords' predicament, this did not affect the court's substantive decision as to whether to approve the plan.

Compromise of landlord’s guarantee claim against plan company’s parent	• Even though there was no possibility of a “ricochet claim” by the parent against the plan company in the event that the landlord claimed on the guarantee (because the parent’s claim against the company was compromised by the plan), various other factors justified the compromise of the guarantee. These included that the compromise was necessary to ensure the group was not at risk of an uncompromised claim against an insolvent parent, to ensure continuity of the parent’s services to the company, and to avoid undermining the basis on which the group was intended to operate post-restructuring.

Costs

The court made no order as to costs, i.e., the opposing creditors must bear their own costs, as the court did not consider their objections substantial enough to justify making an order for costs against the company.

[1] The categorisation of the leases – according to their profitability and contribution to the business – followed the usual approach in the context of company voluntary arrangements and in previous restructuring plans involving lease liabilities (namely *Virgin Active* (2021) and *Lifeways* (2023)). ↩

[2] The plan compromised business rates liabilities relating to “Class C” and “Class D” premises, which would likely remain unoccupied in the relevant alternative (since such sites would not form part of the assets sold in any pre-pack sale). It did not compromise business rates liabilities in respect of “Class A” premises or the three classes of “B” premises (since such sites would likely form part of the assets sold in a pre-pack administration sale and therefore the premises would continue to be occupied). ↩

[3] The payment of business rates for the first 28-day period was intended to ensure that the local authorities were treated in the same way as would likely occur in the relevant alternative of a four-week (i.e., 28 day) M&A process followed by an administration, since the company might continue to occupy the sites during the M&A process. ↩

[4] Under s.901C(4) of the Companies Act 2006. Kirkland advised Smile Telecoms on the only successful use of this provision to date; see our *Alert*. ↩

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Suggested Reading

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