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Cineworld: Court Approves Restructuring Plans Compromising Dissenting Landlords (Despite Contractual Agreement Not to Seek Further Compromise)

30 September 2024

At a Glance

The English Court today approved the restructuring plans of four UK companies in the Cineworld Group, binding dissenting landlord classes. The Court approved the plans in full, notwithstanding a last-minute challenge by certain landlords (the **Opposing Landlords**) with whom Cineworld had previously negotiated rent reductions.

The commercial effects of the plans included restructuring the plan companies' portfolio of leases and related liabilities (including business rates), compromising secured loan obligations and recapitalising the group through new funding.

In yet another groundbreaking case, the Court held that:

- contractual side letters in which Cineworld had agreed not to seek further compromise of the Opposing Landlords were capable of compromise under the restructuring plans;
- the existence of the side letters was not a good reason or proper justification for excluding the Opposing Landlords from the plans;
- excluding the Opposing Landlords from the plans would (at first sight) contravene the *pari passu* principle (which requires equal treatment of creditors who would rank equally in insolvency proceedings), because the Opposing Landlords would be treated unjustifiably preferentially;

- the Opposing Landlords were not entitled to an injunction to exclude their leases from the scope of the proposed plans; and
- the relevant alternative to the plans was insolvent administration (as the plan companies had submitted) and not an alternate restructuring plan which did not compromise the Opposing Landlords (as the Opposing Landlords had argued); accordingly, no member of a dissenting class was worse off under the plans than in the relevant alternative.

This means that debtors which have negotiated contractual compromises with creditors — even if the compromise was made conditional upon the company not seeking a further compromise — can nonetheless seek further compromise of such obligations through restructuring / insolvency proceedings. This is subject to certain safeguards — for example, that the company's financial performance has deteriorated further following the initial compromise and that the company is acting in good faith.

This opens up a major opportunity for companies which have already contractually negotiated compromises under existing leases (or other contracts).

The Court granted one of the Opposing Landlords permission to appeal. The other Opposing Landlord (the Crown Estate) dropped its opposition upon hand-down of today's judgment; it will therefore be bound by the plans.

Kirkland & Ellis advise Cineworld. The convening judgment is here; the sanction judgment is here.

Background

Cineworld's business was severely adversely impacted by the Covid-19 pandemic and government restrictions. This resulted in the Group undertaking a reorganisation under Chapter 11 of the U.S. Bankruptcy Code in 2022-2023. The Chapter 11 plan provided some liquidity and headroom in relation to the group's financial indebtedness but did not address the UK group's lease liabilities in respect of its cinema sites. A significant number of the UK group's leases are "over-rented" (that is, the contractual rent is in excess of market rent). This factor, together with difficult trading conditions arising from the screen actors' and writers' strikes in 2023, resulted in the UK group continuing to suffer severe financial difficulties.

The Restructuring Plans

Cineworld's restructuring plans have five basic features:

1. compromising and releasing the plan companies' secured loan obligations to the Cineworld U.S. group in exchange for warrants for shares in the plan companies, and releasing the plan companies' unsecured intercompany liabilities;
2. recapitalising the Cineworld UK group through £16 million of new equity funding from the plan companies' indirect parent company to fund the UK Group's immediate liquidity needs, with further funding of up to £35 million available to fund capital expenditure;
3. amending and extending time for payment in respect of the plan companies' obligations to their secondary secured lenders;
4. restructuring the plan companies' portfolio of leases (comprising 98 leases in total, although 38 'Class A' leases were not compromised by the plans) by dividing the leases into seven sub-categories using objective criteria and reducing rent to varying degrees (in some cases to £0) depending on the relevant category; and
5. compromising and releasing the plan companies' unsecured property and business rates liabilities.

The landlord-related provisions of the plans followed the model used in company voluntary arrangements and previous restructuring plans including *Virgin Active*, *Lifeways*, *Fitness First*, *Superdry* and *Revolution Bars*.

A total of 32 classes were convened across the four restructuring plans. The secured term loan lenders and secured intercompany lender approved the plans. Among the classes comprising landlords, general property creditors and business rates creditors, results were mixed. Overall, 12 classes approved and 20 classes voted against the plans. Accordingly, the plan companies sought the Court's approval of the plans via "cross-class cram-down".

Judgment

Further compromise of "already-compromised" leases: Cineworld contractually renegotiated certain of its UK leases in 2023. In consideration for rent reductions, the tenants entered side letters agreeing that, if they entered into a restructuring plan or company voluntary arrangement (or scheme of arrangement), then they would not seek to compromise further the relevant leases; instead, the relevant leases would be placed in the "Class A / Green" category with no further amendments.

Cineworld's restructuring plans then sought to impose substantial additional impairments beyond what had been contractually agreed.

The Court accepted Cineworld's evidence that, at the time of the side letters, Cineworld had underestimated the impact of the actors' and writers' strikes on the pipeline of films; the increase in the national living wage was higher than anticipated; and attendances at one site had been >5% lower than anticipated. The Court accepted that, accordingly, the deterioration of the UK group's trading performance since the side letters had been greater than projected.

The Court held that:

- the side letters did not create any class issues for the purposes of voting on the plans;
- nor did the existence of the side letters constitute a jurisdictional roadblock: it was legally possible for the restructuring plans to modify the Opposing Landlords' rights under the side letters;
- the Court "will be slow to enforce agreements which operate to undermine [the *pari passu* principle, which embodies a public policy]. Indeed fidelity to the *pari passu* principle will often justify plan companies in acting contrary to previous undertakings not to include debts within a restructuring";
- questions of fairness in restructuring plans are not concerned with the relationship between the company and individual creditors: fairness in this context is primarily a matter of relative treatment of the creditors as between themselves (with like to be treated as like as the default position); and
- there was "much force" in the plan companies' argument that the Opposing Landlords had left it very late in the day to make their applications, without providing a good explanation: "this is not merely a formal point. The Plans have proceeded on the footing that the relevant leases are part of them, and the companies have modelled the outcomes on that basis".

No injunction: The Court refused to grant the Opposing Landlords' application for an injunction to protect their contractual rights to exclusion from the restructuring plans. The Court held that:

- the negative covenants in the side letters were capable of being compromised under the plans and, if compromised, there would be nothing to enforce by way of injunction; and
- where the threshold conditions for a plan designed to avoid a formal insolvency are satisfied and the *pari passu* principle is engaged, any application to enforce the

contract to exclude relevant creditors will generally have to give way to that principle.

Relevant alternative: The Court found that the correct relevant alternative to the plan, if it were not sanctioned, was (as the plan companies had submitted) insolvent administration, in which it was most likely that the valuable business and assets of the plan companies would be sold. It was most likely that, in the absence of a competing and deliverable offer being obtained in any accelerated marketing process, the assets would be acquired by Cineworld U.S. group (by way of a partial credit bid of intercompany loan liabilities and additional cash payments) or certain of the term loan lenders (by way of a credit bid of term loan liabilities).

The Court rejected the Opposing Landlords' argument that the correct relevant alternative was a restructuring plan which did not compromise their leases. "It would lead to absurdity if any particular creditor could say to the court that the alternative to the plan proposed by a company is the same plan with that particular creditor excluded. It would indeed on one view mean that a company with multiple creditors could never persuade the court that insolvency was the relevant alternative."

Relevant alternative — form of evidence: The Court (at the convening hearing) confirmed that the independent report on the relevant alternative to the restructuring plans must be an expert report. It upheld the practice of having a witness statement from the expert to introduce the relevant alternative report. Kirkland has specifically recommended this practice in the wider market; this is the first judgment endorsing the approach.

Setting recoveries for "out of the money" creditors: For two of the plan companies, there would have been no prescribed part in the relevant alternative administrations (and therefore absolutely zero recovery for unsecured creditors); for the other two plan companies, the only recovery for unsecured plan creditors in the relevant alternative administrations would have been a share of the prescribed part. The Court of Appeal's decision in *Adler* stated (*obiter*) that even out-of-the-money classes must receive a modest amount under a restructuring plan, in order for the plan to constitute a "compromise or arrangement" (as is required by the legislation) rather than an expropriation.

This necessitated the introduction of a £1,000 "floor" as consideration for unsecured plan creditors. Accordingly, the plans provided that such creditors were entitled to the higher of 150% of their estimated insolvency return or £1,000.[1] The Court held that this sufficed to constitute the requisite "compromise or arrangement".

Excluded creditors: The Court found there were good commercial reasons for the exclusion of certain liabilities from compromise under the plans, such as liabilities under 'Class A' leases and liabilities owed to trade creditors, employees and HMRC.

Retention of existing equity: The Court was satisfied that the retention of equity in the group by its existing shareholders was justified. First, the indirect parent was providing new equity funding which would enable the UK group to continue as a going concern — i.e., the shareholders were providing new value to the plan companies which justified their retention of the equity. Second, in any event, as the Court of Appeal's judgment in *Adler* indicated, it is for the "in the money" creditors to determine the allocation of the equity.

Settlements: The plans were amended in certain respects following correspondence from certain landlords, including following the creditor votes. The Court found that the settlements were appropriate and in the best interests of plan creditors; it sanctioned the plans including appropriate modifications reflecting the settlements. The plans remained substantially the same as voted on and the modification was not imposing a different plan on consenting creditors; creditors' approval was not called into question by reason of the modification.

Discretion: The Court accepted that the dissenting classes were "out of the money" in the relevant alternative to the plan (save in very limited respects); accordingly, their views ought to be given little or no weight, based on existing case law.

The Court was satisfied that the plans were fair in their treatment of creditors:

- the allocation of benefits was appropriate and fair given unsecured creditors were substantially out of the money;
- the differential treatment of landlords under the plans — as has become common in plans involving lease liabilities — conformed to the general principle that creditors who would have the same rights in the relevant alternative should be treated in the same manner in a restructuring plan, unless there is a good reason or proper basis for a departure;
- there is nothing inherently unfair in a restructuring plan proposing long-term modifications to leases, provided affected landlords are offered a break right (the exercise of which would leave the landlord no worse off than in the relevant alternative to the plan);
- if the Opposing Landlords were to be excluded from the plans, this would (at first sight) contravene the *pari passu* principle;

- similarly, the consequence of enforcing the side letters would mean that the Opposing Landlords would be in a significantly better position that other creditors objectively in the same classes as the Opposing Landlords; the Opposing Landlords would be treated unjustifiably preferentially;
- the specific undertaking in the side letters not to seek a further compromise was not so different from an ordinary contractual promise (e.g., to pay rent) as to have a "decisive consequence";
- the existence of the side letters was not a good reason or proper justification for exclusion of the Opposing Landlords from the plan: "excluding these particular landlords would not facilitate or improve the prospects of success of the restructuring plan"; and
- there was no case of bad faith on the part of the plan companies nor evidence that other creditors were unfairly benefitting at the expense of the Opposing Landlords.

The Court also confirmed that the Court of Appeal's judgment in *Adler* (as to the need for proper justification to diverge from the *pari passu* principle) is not restricted to situations in which there is to be an orderly wind-down of the business under the restructuring plan.

Compromise of guarantee of Irish law lease: The plans compromised an Irish law lease guarantee given by a plan company in respect of a lease of premises in Ireland. (The lease itself was not included in the plans.) Lawyers acting for the relevant plan creditor had queried the effectiveness of the plans in Ireland. However, the Court accepted expert evidence that there was a real prospect of the plans having substantial effect in Ireland.

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1. Guaranteed landlord creditors will receive the aggregate of their estimated return in the administration of the relevant plan company and the administration or liquidation of the relevant guarantor. ↩

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- 23 September 2024 Kirkland Alert *Wirecard:* German Appeal Court Rules Shareholder Damages Claims Rank *Pari* to General Unsecured Claims
- 19 September 2024 Kirkland Alert German Court Erases Shareholder Holdout Plays Against German Restructuring Schemes: Shareholders' Consent Not Required if Only Alternative is Insolvency
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