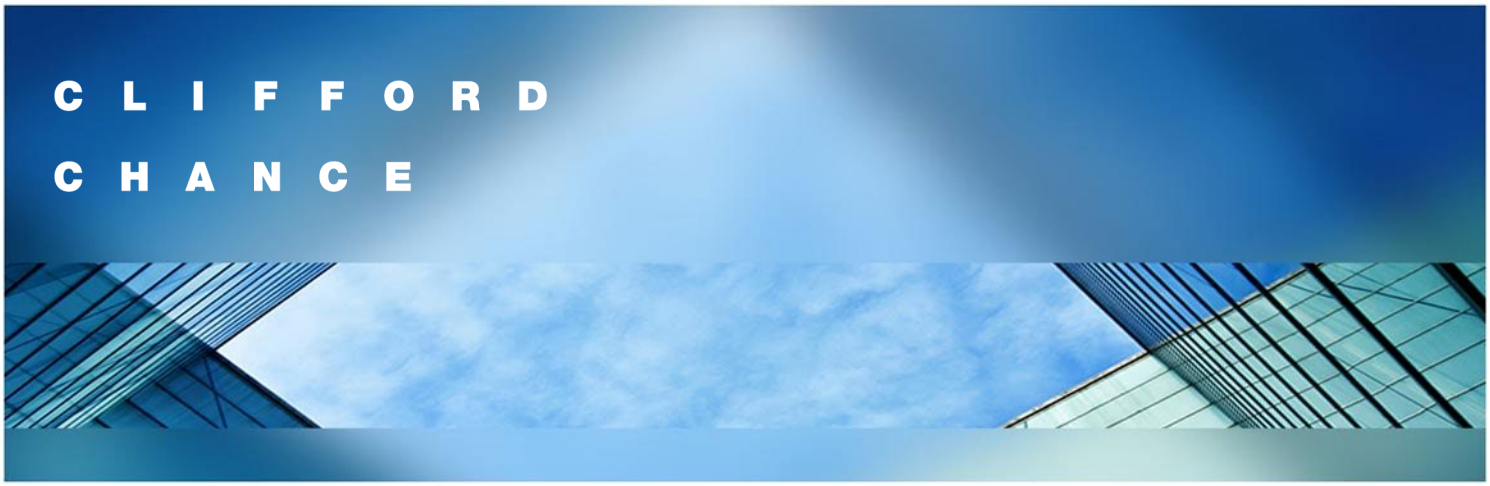

COURT OF APPEAL EXPLAINS ITS REASONS FOR UPHOLDING THAMES WATER PLAN

We already knew the outcome of the Court of Appeal's decision to uphold Thames Water restructuring plan provided on 17 March.

On 15 April, the Court of Appeal provided its reasons for doing so. [1] We understand that the Court of Appeal has allowed the parties until 25 April to apply for Permission to the Supreme Court, should they wish to challenge the restructuring plan. Overall, the decision reinforces the flexibility of restructuring plans as a tool for companies seeking to restructure, emphasises the court's critical oversight role in ensuring equitable outcomes for the parties involved, and clarifies the limits of the issues that the Court will have within its contemplation.

Limits of the appeal

The appeal was based on a challenge to the first instance judge's decision to sanction the plan, in his discretion. It was recognised that the Court of Appeal would not interfere with the first instance judge's decision unless he had applied incorrect legal principles, misapplied or omitted to consider the facts, or came to a decision that no reasonable judge could reach. The focus of the appellants' case against the interim plan related to the high cost of the interim funding and the control the plan afforded to the Class A creditors in relation to the longer-term restructuring (RP2). Despite hearing arguments, the Court of Appeal decision does not address any issues in relation to valuation or comment upon whether a special administration was a more appropriate route to facilitate a restructuring. The appeal, as we already know, was unsuccessful and the interim restructuring plan upheld.

Some key takeaways from the decision are set out below:

Key issues

- Court of Appeal provides reasons for upholding the plan.
- A good reminder that the court's approval provides checks and balances in order to protect creditors.
- Reinforces the availability of a restructuring process that has overall fairness at its heart.
- Court of Appeal reminds companies to make valuation materials available in a timely manner, and that parties must co-operate to narrow the issues before the court.
- Restructuring plans are a flexible restructuring tool; past cases are a useful guide but must be considered in context.
- Out of the money creditors whose rights are being compromised cannot always be ignored when the court is considering the overall fairness of the plan.
- Costs of the plan were not a 'blot'.
- Court did not have a responsibility to enquire whether a special administration would better serve the public interest. It was for the Secretary of State and the regulator to determine whether a special administration was in the public interest.
- Third party releases must be necessary for the implementation of the plan, and the Court required a carve-out for claims brought by a future special administrator or insolvency officeholder for releases given to directors and the company's advisers.

[1] *Re Thames Water Utilities Holdings Limited* [2025] EWCA Civ 475

Flexible nature of the restructuring plan process

The Court of Appeal's decision emphasises the flexibility of the plan process and the fact that it can be used to implement a wide array of restructurings from simple "amend and extends" to balance sheet restructurings, including both operational and financial, facilitating debt write-downs, debt to equity swaps or simply effecting distributions to creditors. As a result of this flexibility, the Court of Appeal has reminded parties that when considering restructuring plans, the court will always take into account the particular circumstances of the case. While guided by principles established in prior cases, the guidance from those cases should always be considered within their specific context. The Thames Water plan was an interim plan, designed to provide a bridge to an "RP2" and therefore very different from some of the other plans the English Court has been asked to approve. For example, it was very different from the distribution plan promoted in *Adler*[2] and while it confirms key concepts considered by the Court of Appeal in that case, it also clarifies the treatment of 'out of the money creditors' and how the 'benefits of the restructuring', including intangible benefits and how those benefits are allocated, factor into the court's consideration of fairness as between those affected by the plan. It also confirms certain aspects of the *Adler* case, particularly the different fairness test applicable in cross-class cram down cases. Generally speaking, therefore, it has not changed the English Court's approach to restructuring plans in any significant regard.

Agility of the English Court

It is important to note that the court's sanction has always been an integral part of the restructuring plan process; the *imprimatur* of the court is a necessary and valuable step in that process. The court acts as a safeguard for creditors and provides certainty for the plan company. The court's two-stage oversight regime and predictable way in which the English court exercises its discretion is well-known and well-regarded.

The recent appeal process in Thames Water has also demonstrated that the English court is agile in terms of providing decisions in genuinely urgent cases. But it also sends a warning (repeating by reference to *Adler*) that parties should ensure that they co-operate to focus and narrow the issues to be considered by the court where possible. Narrowing the issues includes trying to seek consensus where possible in negotiations; restructuring plans involve compromise, where some give and take is essential. In cases where not everyone is able to agree, the court provides a vital role in ensuring that the restructuring is fair. Parties are reminded that they need to provide interested parties sufficient time to prepare for hearings, give the court appropriate time to hear the case and to deliver a reasoned decision, and permit time for the determination of any application for permission to appeal. The court will be robust in exercising its case management if this is not adhered to. In this case, the Court of Appeal notes that parties appeared to have failed to adhere to this previous guidance and that while the company was 'running on fumes' by the time of the appeal and the urgency of the matter was real, such distress and pressure on the liquidity runway had 'hardly come as a surprise' and in ignoring the recommended practice had put the court under unacceptable pressure.

[2] *Re AGPS Bondco Plc* [2024] EWCA Civ 24

The Court of Appeal's comments in this regard underline the importance of seeking advice and entering into restructuring negotiations at an early stage albeit it is also true to say that negotiations can be difficult to control for a company with multiple creditors.

Fairness and out of the money creditors

One of the key features of a restructuring plan process has always been the fact that it has relied upon the court's discretion to approve the plan, even in cases where all creditor classes have approved the plan in the requisite 75% majorities. In this case, the court's discretion involved ensuring fairness among creditors, where certain out of the money classes dissented and the approval relied upon cross-class cram down. The Court of Appeal followed the fairness test articulated in *Adler*, reaffirming the principle that the relevant alternative is a central concept in assessing the fairness of a restructuring plan (in this case the special administration), particularly in the context of the 'no worse off' test and the horizontal comparison of creditor treatment, including the need to consider whether there was a better or fairer plan in cross-class cram down cases. However, the Court of Appeal also clarified that the fact that a particular class of creditors might be out of the money in the relevant alternative does not mean that the court can ignore their interests entirely when considering whether the plan is fair. The Court of Appeal held that being out of the money in the relevant alternative was not in itself a reason to exclude the creditor entirely from the consideration of whether the benefits preserved or generated by the restructuring are fairly allocated among all creditors who are compromised under the plan. Of course, there may still be cases, for example, where a restructuring plan is being used as a liquidation distribution mechanism and where a certain class of creditors are so far out of the money that their interest can be excluded. In this case, it was noted that the Class B creditors who were out of the money creditors could not be ignored and had contributed to the benefits of the restructuring along with the Class A creditors. The purpose of the plan was to extend the maturity dates and provide new monies, thereby preserving Thames Water as a going concern in the short to medium term, to enable it to pursue RP2. It was recognised that the Class B Creditors' postponement of the maturity date under the plan was as critical as the maturity dates being postponed in respect of the Class A loans, holding that both creditors contribute equally in this respect to the benefits of the plan and therefore Class B creditors' interests were a relevant consideration in the exercise of the discretion in respect of fairness. Providing Thames with an opportunity to pursue a longer-term plan was considered a relevant benefit of the interim restructuring (referred to more narrowly in other cases as the 'restructuring surplus'). Thus, the judgment clarifies that the concept of restructuring surplus should be understood more broadly to the 'benefits of the restructuring' which include intangible benefits that a restructuring plan might preserve or generate; in this case, it included benefits provided by the Class B creditors.

As the nature of the plan did not include any attempt to disenfranchise the Class B creditors in this case, it was unnecessary for the Court to decide whether the Class B creditors had a genuine economic interest in the company in the relevant alternative (i.e. the SAR). That was left for another day.

Third party releases

The Court of Appeal's direction that certain third-party releases must be narrowed is a key development in the case. In this case, Thames' directors,

officers, and advisers benefited from releases related to the negotiation, preparation, sanction, or implementation of the interim plan and related transactions. The Court of Appeal noted the difficult circumstances in which the directors and officers were operating and made clear that there had been no allegations as to any wrongdoing in this case. Furthermore, the Court of Appeal noted that such releases are often included in restructuring plans to prevent undermining the plan through "ricochet" claims against third parties (i.e. those third parties who would have equivalent recourse to the companies being restructured as a result of claims being brought against them). However, in this case, the release related to claims belonging to the plan company or the operating company against their own officers and advisers, so there was no ricochet. While recognising that the ricochet claims were not the only justification for the releases of third parties, the Court of Appeal noted that the overriding consideration in the Court's approach to such releases is to determine whether they were necessary to the plan being proposed. In this case, the Court of Appeal was not satisfied that these releases were necessary to enable the interim plan to be implemented. Ultimately, the Court decided that the releases should include a carve-out for any claims that might be brought by a special administrator of the operating company or an insolvency officeholder of the plan company should the interim plan not be successful and result in a special administration. This change had already been dealt with by way of modification made to the plan before the Court of Appeal provided its reasoning.

Public interest

The Court of Appeal judgment considered the challenge made on public interest grounds in the context of the high costs associated with the plan. It had been argued that the plan was not in the public interest due to its excessive costs compared to a special administration. The judge at first instance had acknowledged the high costs but concluded that they were balanced by the negative financial impacts of a special administration; he also noted the public interest in facilitating the rescue of struggling companies and gave weight to the fact that Ofwat and the Secretary of State did not oppose the plan. He ultimately decided that the plan should be sanctioned, as it was in the public interest to give the market a chance to agree on a permanent restructuring plan before resorting to a special administration. The Court of Appeal agreed with this approach.

Furthermore, the Court of Appeal noted that the inability of the creditors to agree to a solution does not vest in the court a responsibility to conduct a wider enquiry as to whether the plan or the special administration would better serve the public interest. The decision to appoint special administrators rests with Ofwat and the Secretary of State. The fact that the special administration would be the inevitable consequence of refusing the plan did not provide the Court with a reason to "usurp" their functions.

Costs were not a blot on the plan

The decision discusses the concept of a 'blot' on a scheme or plan, which refers to a defect that might make the scheme unlawful or inoperable. In this case, the issue arose in the context of the costs which arose under the plan. The Court of Appeal held that the judge in this case was entitled to conclude that the overall costs of the intended restructuring plan were at least equal to the negative impact of the SAR and that there was no blot to lead the court to refuse the sanction.

Practical implications of the decision

- The case is a reminder about having sufficient time to facilitate a restructuring which includes seeking advice at an early stage, including early advice on potential contentious aspects of the plan.
- Parties need to come to the table earlier in the distress cycle, so that negotiations can take place and allow parties to have a sufficient runway and liquidity to implement the restructuring; factoring in sufficient court time is essential.
- When devising plans and compromising stakeholder interest, the court's broad approach to fairness needs to be a central focus of the plan negotiations. There needs to be consideration of the treatment of creditors in relation to the overall approach to fairness, including in relation to 'out of the money' creditors; they cannot always be ignored.
- It goes without saying that acting reasonably in negotiations and treating parties fairly in those negotiations will allow restructurings to take place more efficiently.
- Aggressive compromises, even if they meet the statutory criteria, must still get approval from the courts; this means being prepared for challenges. This may be more relevant given the coming wave of LME type transactions sweeping across the Atlantic.
- Third party releases can legitimately be part of the restructuring plan as long as they are justified and necessary to the implementation of the plan.

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