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Alternate Realities

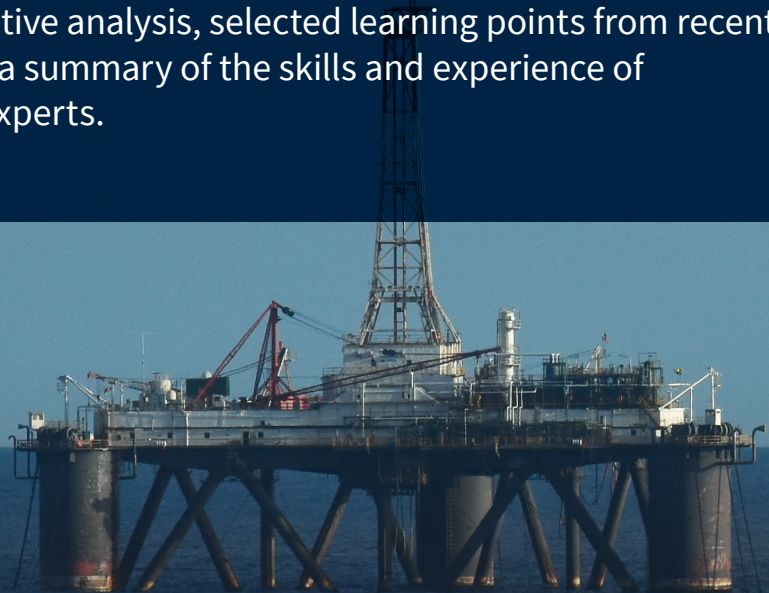
DEVELOPING ROBUST RELEVANT ALTERNATIVE ANALYSIS



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██████████ The recent Hurricane Energy Restructuring Plan judgment emphasises
██████████ the importance of the Relevant Alternative analysis for Restructuring
Plans. The cross-class cram down function of Restructuring Plans,
together with the possibility to apply to exclude a class from voting
where the court is satisfied that none of the members of the class has
a genuine economic interest means that robust Relevant Alternative
analysis is fundamental to a successful plan.

In this context, we set out the key issues to consider when formulating
Relevant Alternative analysis, selected learning points from recent
judgments, and a summary of the skills and experience of
FTI Consulting experts.



What is the Relevant Alternative and why is it important?

The Relevant Alternative is the most likely outcome were a Restructuring Plan to fail. Dissenting creditors may seek to challenge the Relevant Alternative given its importance.

What is the Relevant Alternative?

In a Restructuring Plan, consideration must be given to the Relevant Alternative, which is whatever the court considers would be most likely to occur in relation to the company if the compromise or arrangement were not sanctioned. The Restructuring Plan's Relevant Alternative is conceptually similar to the comparator in a Scheme of Arrangement ("Scheme").

The Relevant Alternative may often be an insolvency scenario, although this should not be a default assumption.

Why is it important?

Two key concepts in the Restructuring Plan are genuine economic interest and cross-class cram down. These concepts result in the Restructuring Plan's Relevant Alternative potentially being crucial as they could see classes of debt or equity either:

- not invited to vote on the plan (if deemed to not have a genuine economic interest); or
- compromised even if the class votes against the plan (under the "no worse off" test).

KEY CONCEPTS IN RESTRUCTURING PLANS

Genuine economic interest: In a Restructuring Plan, if the court agrees that a class of debt or equity has no genuine economic interest in the company, then that class does not need to be invited to vote. Therefore in such circumstances, valuation considerations are likely to be considered at the sanction hearing under a Restructuring Plan.

Cross-class cram down: The potential for cross-class cram down is one of the key advantages of the Restructuring Plan over a Scheme – i.e. a Restructuring Plan may still be sanctioned by the court where one or more classes vote against it. One of the conditions for cross-class cram down is that none of the members of the dissenting class (or classes) would be any worse off under the Restructuring Plan than they would be in the event of the Relevant Alternative ("no worse off" test).

Determining the Relevant Alternative and Stakeholder Outcomes

Relevant Alternative analysis requires careful consideration of the consequences of a failed Restructuring Plan, reflective of the specific fact pattern, and well-evidenced analysis.

ASSESS FACTORS THAT MAY INFLUENCE THE RELEVANT ALTERNATIVE

Factors that may influence the choice of the Relevant Alternative will be specific to the circumstances and may include:

- Runway to develop and implement options – often but not always driven by liquidity.
- Marketability of the asset and likely success of a sale process.
- Whether challenges faced are operational or financial in nature, or both.
- Directors’ duties – applicable laws will vary by jurisdiction.
- Status of stakeholder negotiations, lock-ups, and potential stakeholder actions.
- Factors impacting ability to trade in an insolvency e.g. considering commercial, liquidity, regulatory, employee and other factors.
- Extent/severity of potential insolvency contagion.

DETERMINE THE RELEVANT ALTERNATIVE

Restructuring Plans are often contemplated in the context of a challenging solvency situation for a company. As a result, the Relevant Alternative is often an insolvency scenario. Examples include:

- Holding company only insolvency and sale of shares in operating companies.
- Pre-pack insolvency scenarios.
- Trading in insolvency (to either a sale or a closure).
- Group-wide liquidation.

Non-insolvency Relevant Alternative scenarios may also merit consideration, for example:

- Managed wind-down.
- Alternative consensual outcomes.
- Accelerated M&A.

UNDERTAKE ENTITY PRIORITY MODEL (“EPM”) ANALYSIS

Once the basis of the Relevant Alternative has been determined, the outcomes to stakeholders from that scenario must be determined. This is often modelled using an EPM.

An EPM is traditionally a group-wide insolvency analysis built up on an entity by entity basis and aggregated taking account of the intercompany flows and equity flows around the group.

Enterprise valuation data can be an input into the EPM to reflect share sale assumptions.

Other key inputs are the realisable value of assets and the creditor claims that would arise in the selected scenario.

These inputs are determined based on experience, professional judgment, and review of relevant data and evidence.

Relevant Alternative and Scheme Comparators in recent cases

The court's refusal to sanction Restructuring Plans or Schemes in recent cases has been partly attributable to issues with the Relevant Alternative or Comparator.

COMPANY ⁽¹⁾	PROCESS ⁽²⁾	BASIS OF THE RELEVANT ALTERNATIVE / SCHEME COMPARATOR	SANCTION? ⁽³⁾
Virgin Atlantic	RP	Administration with sale of certain assets and orderly wind-down of the rest of the business.	✓
Pizza Express	RP	Pre-pack sale of shares to a single purchaser was deemed the most likely Relevant Alternative. Asset realisation scenario also considered, but not selected.	✓
DeepOcean	RP	Scenarios considered were (i) liquidation of plan companies only and (ii) group-wide liquidation. Scenario (i) considered most likely and selected as the Relevant Alternative.	✓
Gategroup	RP	Liquidation was the Relevant Alternative. An illustrative assessment of recoveries from a pre-pack administration sale was provided which showed better outcomes compared to liquidation, but was not considered viable.	✓
Virgin Active	RP	Accelerated sale of UK business in administration process, with international divisions sold via share sales. Group-wide liquidation considered, but considered to be a less likely outcome.	✓
Hurricane Energy	RP	Controlled wind-down was considered the Relevant Alternative. The court disagreed with the analysis supporting the Relevant Alternative choice and the Restructuring Plan was not sanctioned. The next steps remain uncertain.	✗
NCP	RP	Pre-pack administration selected as the Relevant Alternative. Plan suspended following (i) offers received for the equity and (ii) an extension to the moratorium on commercial rents. NCP is continuing to assess the available options.	✗
Sunbird	SoA	Liquidation assumed. Initial Scheme was not sanctioned — in part given an insolvency practitioner was not engaged and only limited information was disclosed to creditors. Sanctioned at the second attempt.	✗
Amigo Loans	SoA	The directors considered administration would follow immediately if the Scheme was not sanctioned. Court did not consider this likely and refused to sanction the Scheme. Amigo loans is working with the FCA and considering options.	✗

Note: (1) This is a sample of cases and not an exhaustive list, for example, Smile Telecom was also sanctioned with cross-class cram down.

Note: (2) RP denotes Restructuring Plan and SoA denotes Scheme of Arrangement.

Note: (3) The Relevant Alternative / Comparator was a factor where sanction has not been achieved, albeit there may be a number of factors at play.

Precedents and Learning Points (1/2)

Recent cases and judgments are informative and provide clarity as to the court's expectations, albeit key points can often be situation specific and therefore should not be considered general rules.

VIRGIN ACTIVE

- Scenarios that may be available if different past actions had been taken are irrelevant.
- Multiple potential scenarios may be possible, but the most likely must be determined.
- There is no absolute requirement to market test – a desk-top enterprise valuation was appropriate in this case.
- The valuation approach should be clearly explained, identifying and justifying the selection of the primary valuation methodology and any secondary cross-check approaches considered.
- Key valuation assumptions should be clearly explained and evidenced.
- Some level of uncertainty and a level of disclaimers is reasonable.
- It may be appropriate to apply a distress discount to enterprise valuations, e.g. reflecting compressed timetable or lack of seller representations.
- Challenges to valuations should be made by valuation experts.
- In challenging, it is better to propose an alternative valuation compared to solely a critique of the presented valuation.

HURRICANE ENERGY

- The court will closely evaluate the Relevant Alternative evidence – particularly where there is no imminent liquidity crunch.
- The details of the Relevant Alternative were subject to differing views – this was highly fact specific in relation to whether a vessel charter would have been extended.
- It was sufficient in this case for opposing stakeholders to demonstrate that there was a reasonable prospect of a better outcome than the plan – it was not necessary to specify the exact alternative scenario. Burden of proof is on the company proposing the plan.
- The court considered in this case that it should take a broad view in determining whether stakeholders would be any worse off.
- The court was willing to consider potential upside from future trading in considering fair allocation of value between stakeholders, particularly given lack of burning platform and uncertain factors such as oil prices.
- Potential replacement of board directors is not a ground for urgency.

Precedents and Learning Points (2/2)

NCP

- In this case, new evidence emerged in the form of (i) bids for the company and (ii) extension to commercial landlord moratorium. The new evidence impacted NCP's assessment of the Relevant Alternative, and therefore NCP suspended the Restructuring Plan process to allow for consideration of further options. This underlines the importance of being alive to changes in evidence which may require a change in strategy.

SCHEME OF ARRANGEMENT CASES

- Sunbird / Amigo: comparator analysis remains critical in schemes.
- Sunbird: independent analysis and adequate information disclosure is critical.
- Amigo: courts will refuse to sanction if not just and equitable (even where classes have voted in favour)⁽¹⁾.
- Amigo: in this case, the judge considered that a revised Scheme proposal may be the appropriate comparator, rather than an insolvency.
- Amigo: rationale or evidence supporting the selected scenario must be presented – e.g. there was no evidence of a liquidity crunch leading to an imminent insolvency filing.

OTHER CASES

- It is for the “in the money” stakeholders to determine how surplus value is allocated (DeepOcean).
- Specialist evidence may be appropriate in some cases (e.g. Virgin Atlantic engaged aviation valuers, and DeepOcean engaged vessel valuers).
- Illustrating a scenario with better returns than the Relevant Alternative, and explaining why this is not viable provides a transparent data point (e.g. Gategroup: the pre-pack was not considered viable but the outcome was presented for transparency – the pre-pack outcome was better than liquidation but worse than the Plan proposal).
- Commonly adopted valuation methodologies coupled with real world judgments about what values are likely to be realisable are preferable to computational approaches (e.g. Monte Carlo simulation) and IMO Car Wash remains a valid precedent.
- Challenge to presented scenarios needs evidence e.g. dissenting creditors to the Steinhoff scheme disagreed with the basis of the comparator, but this was seen as a generalisation without specific evidence.

Note: (1) The FCA opposed the Amigo Scheme. The judgment made the point that in this case a key creditor class lacked the information or experience to allow them to properly consider their options.

Producing Relevant Alternative analysis in practice

Given the importance of the Relevant Alternative evidence, this should be developed at an early stage in the process and should be prepared in a robust manner.

Evidence needs to be available at an early stage



Ideally evidence should be available as early as possible to assist in shaping the restructuring negotiations and proposal. Otherwise there is a risk that a deal is negotiated which cannot be supported by the evidence. Plan companies will need initial evidence in place by launch (Practice Statement Letter) stage at the latest.

Where an application is being made such that stakeholders are being excluded from voting on the basis of no genuine economic interest, robust final form evidence will need to be available for the convening hearing.

Robust evidence is required, particularly when dissent expected



Although recent cases provide helpful direction, it is important not to assume precedents are relevant to every scenario – there will typically be a material element which is situation specific.

The supporting rationale should be set out clearly and comprehensively, whether this relates to the selection of the Relevant Alternative or the choice of valuation methodology employed. It is clear that the court will expect there to be evidence prepared by professionals with appropriate skills and experience in a diligent manner, taking into account professional judgment and the facts of the matter at hand.

Valuation considerations

We set out below factors to consider when scoping a valuation in a contentious context and areas typically addressed in detailed valuation exercises.

Factors to consider when scoping a valuation in a contentious context:



Ideally the valuer would have:

- at least 3 weeks to produce a valuation;
- access to a full suite of financial information, including recent forecasts;
- access to individuals who can answer questions on the financials (e.g. management); and
- information on any recent M&A activity relating to the business.

Whilst not an absolute requirement, in certain circumstances it may be beneficial to perform a market testing process to support a desktop valuation approach.

Areas typically covered in detailed valuation exercises:



Review of the historical and forecast financials to enable the valuer to form a view on a reasonable central case projection, maintainable EBITDA and other valuation adjustments (e.g. to account for debt-like items).

Consideration of multiple valuation methodologies such as DCF and multiples approaches to triangulate on a concluded valuation range, including clear explanations as to the priority or weightings given to each approach. It may be appropriate to consider other valuation benchmarks such as secondary debt trading, LBO analysis, and prior offers made for the company.

Detail and supporting evidence should be provided to support key valuation assumptions (e.g. WACC and terminal value).

Consideration of potential discounts to the values implied by the DCF and market approach analyses in order to account for an accelerated / distressed sale process if that is the basis for the Relevant Alternative.

Why FTI Consulting?

With more than 6,400+ employees and offices in 29 countries on six continents, FTI Consulting's breadth and depth extends across every major social, political and economic hub around the globe.

Market leading UK restructuring team

Our UK restructuring team operates as part of a global team of 1,600 Corporate Finance & Restructuring professionals worldwide. Our UK team has been involved in many high-profile restructuring cases and frequently collaborates with our international colleagues to deliver on complex, cross-border cases.

Deep insolvency and entity priority model experience

Our insolvency practitioners have significant experience advising on Relevant Alternatives, scheme comparators and EPM matters together with strong insolvency implementation experience. We have the know-how to ensure our clients successfully and efficiently navigate Restructuring Plan and scheme processes.

Leading valuation and disputes team

Our valuation and disputes team has extensive experience providing valuation advice in restructuring situations and has three times as many expert witnesses as our closest competitors (Who's Who Legal, 2021).

Selected Experts



LISA RICKELTON

Senior Managing Director
Insolvency expert

Lisa is a licensed insolvency practitioner and chartered accountant with over 20 years of experience. Her experience on Scheme Comparators and Relevant Alternatives in Restructuring Plans and EPM analysis includes both EPM build and review on cases such as ED&F Man, DeepOcean, Nyrstar, Low & Bonar, Carillion and Steinhoff.



ALEXIS ANAMAN

Senior Managing Director
Restructuring valuation expert

Alexis has provided valuation advice in over 100 restructurings situations and his formal valuation opinions have been used to support a wide range of restructuring solutions including Schemes, pre-packs and share appropriations. He also has significant transaction experience and has led several accelerated M&A processes.



MARK BEZANT

Senior Managing Director
Valuation and disputes expert

Mark has been appointed as an expert witness or independent expert on over 325 occasions, to assess valuation, damages or accounting issues, and has testified over 60 times. He was the founding chair of the Valuation Community of the Institute of Chartered Accountants in England and Wales, a position he held from 2007 to 2016.



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*Number of total shares outstanding as of July 22, 2021, times the closing share price as of July 29, 2021.

NYSE:FCN

Publicly traded

\$4.9B

Equity Market Capitalisation*

1982

Year Founded

55

53 of Fortune Global 100 corporations are clients

8/10

Advisor to 8 of the world's top 10 bank holding companies

96/100

Advisor to 96 of world's top 100 law firms

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