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Case: Re AGPS Bondco plc [2023] EWHC 415 (Ch) (convening), Sir Anthony Mann, 27 February 2023; [2023] EWHC 916 (Ch) (sanction), Leech J, 21 April 2023

Synopsis: The High Court sanctioned a restructuring plan for the German real estate group, Adler, binding a dissenting class following strong opposition from that class. Their opposition centred around the claim that their existing pari passu claims would be subordinated under the plan and, given that this was a 'liquidation plan' (the business would not be saved as a going concern), this would breach the pari passu principle. Additionally, the opposing stakeholders disputed the company's evidence that the dissenting class would achieve better recoveries under the plan than in the relevant alternative.

Topics covered: **Restructuring Plans; cross-class cram-down; pari passu principle; distribution of benefits; valuation dispute; "blot**

Comment

A big battleline in the opposing stakeholders' attack on the plan centred around the allegation that the plan violated the pari passu principle that would apply in a formal liquidation. Departure from this principle, the opponents argued, should only be approved where it is necessary to rescue the company as a going concern – not in a wind down scenario. The court did not have to decide on when an infringement to the *pari passu* principle might be justified, given it ultimately held that the plan did not breach *the pari passu* principle because it was most likely that all noteholders would be paid in full under the plan. The court did however note that, had it not been prepared to accept the company's evidence on this point, it might have held there was an unfair departure from the *pari passu* principle, and this might have constituted a fundamental objection to sanctioning the plan.

The opposing stakeholders were an ad hoc group of holders of notes due in 2029 (the AHG). The AHG had clearly taken Snowden LJ's comments in *Smile* (Technical Bulletin 986) to heart, engaging both real estate and financial advisers to prepare an alternative valuation which it presented to the court. It is perhaps not surprising that the court found the plan company's evidence, which had been prepared over a much longer period of time with more available data, was on the balance of probabilities more convincing. Future challengers will take note that the court reiterated that satisfying the 'no worse off' test for cross-class cram down did not require ***certainty***, but merely an assessment of probability based on the evidence presented. The court also noted that creditors can be themselves the best judges of whether they will be better off under the plan. The court was conscious that even within the dissenting class, a numerical majority of creditors (62%) had approved the plan.

Discussing fairness more generally, the court drew comparisons between a claim of unfair prejudice relating to a CVA and the analysis of fairness in sanctioning a plan using cross-class cram down. The mere presence of differential treatment between creditors would not be enough to cause a court to refuse its approval for a plan or to hold a CVA proposal to be invalid, although such a horizontal comparison will play into the overall assessment of fairness.

For various reasons, the court held it was not unfair to require the 2029 noteholders to accept a greater level of risk than other noteholders (by preserving their existing temporal subordination and becoming subordinated to €935m new money and a series of notes due 2024, whose maturity was extended under the plan). Ultimately, the court was persuaded by the company's submission that if the plan works, "*everyone is better off and the best judges of this are the plan creditors themselves, who voted by the requisite majority in every class for the plan and by 62% in the dissenting class. Given the balance of risk, the right exercise of discretion is to give the management of the Group the opportunity to implement it*".

The judgment also highlights the court's approach to matters of foreign law. First, the court was faced with expert evidence from both sides as to whether the substitution of the English plan company as issuer was valid under German law-governed notes. Secondly, the court was asked to decide whether acceleration notices sent by some 2029 noteholders before the plan meetings were in line with German law. The court was generally reluctant to present its own view where a German court would be far more equipped to interpret its domestic law, only doing so to the extent that the answer might pose a roadblock to sanctioning the plan. For example, the acceleration issue did not go to the heart of whether the plan could reasonably be sanctioned, so the court avoided providing an interpretation of German law. However, the court did fully engage on the issuer substitution point, given its core importance to the plan's functioning, in spite of the fact that separate proceedings in Frankfurt on this point had been commenced.

The court denied the AHG permission to appeal – although permission from the Court of Appeal has now been sought.

Facts

The Adler group deals with the purchase, management and development of residential real estate in Germany. Following global economic downturns, the group saw decreasing demand for their services and faced significant financial troubles. The group was also facing corporate governance problems and was struggling to find an auditor.

Adler's main financial creditors were creditors under six issues of notes with maturity dates ranging from 2024 to 2029.

In December 2022, Adler was unsuccessful in a consent solicitation, with the series of noteholders whose maturity date was the latest, 2029, voting against. In order to effect the proposed restructuring, the group launched an English restructuring plan in early 2023. To make the English process possible, the group incorporated an English subsidiary which it substituted (in accordance with the terms of the notes) as principal debtor in respect of the notes.

The purpose of the restructuring plan was to enable an orderly wind down, with a disposal of all assets and liquidating all of its entities in 2027. The terms of the restructuring plan principally involved a maturity extension of the first series of notes only (with priority given to those 2024 noteholders), new money funding and an interest payment holiday. The relevant alternative scenario put forward by the plan company was immediate formal insolvency proceedings.

The High Court granted permission to convene six plan meetings (one for each class of noteholders) on 27 February. The convening hearing saw little challenge, it being agreed by the court and the parties that the primary challenges could be brought at the later sanction hearing, given time pressures. At the meetings, each class, bar the 2029 noteholders, voted with large majorities in favour of the plan (ranging from 80% to 98% approval). The class of 2029 noteholders failed to reach the requisite statutory majority of 75% but obtained a numerical majority of 62%.

Decision

Leech J sanctioned the restructuring plan following a fiercely contested three-day hearing. The AHG brought a number of challenges, as set out below.

Jurisdiction
The AHG argued, adducing German law expert evidence, that the English courts lacked jurisdiction to hear the case, arguing that the issuer substitution had infringed German law principles and was therefore invalid. The court however agreed with the company's expert on the point, holding that the English plan company had been validly substituted as issuer. The court noted that ongoing proceedings were being carried out in Frankfurt by a member of the AHG on this same issue. Nonetheless, it found that the substitution clause used was standard and in line with German statutory requirements.

Statutory cross-class cram-down tests
Where not every class has voted by the statutory majority in favour of the plan, the court may sanction a restructuring plan under s901G if two statutory conditions are met.

- Condition A: If the restructuring plan is sanctioned, would any member of the dissenting class be any worse off than they would be in the event of the relevant alternative? This is often described as the "no worse off" test.

- Condition B: Has the restructuring plan been approved by 75% of those voting in any class that would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative?

Here there was no dispute that Condition B was satisfied. The company's expert evidence was that the plan creditors were likely to recover 63% of their (pari passu) claims in insolvency proceedings under the relevant alternative. The AHG's expert evidence was that they were likely to recover 56% in insolvency proceedings.

Condition A: 'No worse off'
The court however spent considerable time evaluating Condition A. Adler projected full payment to all noteholders under the plan and 63% in the relevant alternative. By contrast, the AHG provided their own valuation evidence, claiming that Adler had overstated the

value of the group's assets and that the 2029 noteholders would only recover 10.6% under the plan. They argued that therefore Condition A was not met.

The court dealt with the issues in three stages, as set out by Snowden J (as he then was) in Virgin Active (Technical Bulletin 912).

Stage 1: the relevant alternative
It was common ground that the relevant alternative to the plan was a formal insolvency process.

Stage 2: the consequences for the dissenting class
The court found that - on the balance of probabilities - the most likely outcome was that the 2029 noteholders would receive 63% of their principal, in accordance with the sums forecast (and insolvency discounts adopted) by the company's advisers.

Stage 3: the outcome and the consequences for the dissenting class of creditors if the plan is sanctioned
While the court noted that valuations involve an inherent amount of uncertainty, the court preferred Adler's assessment of projected returns under the plan and in the relevant alternative. The court noted that it will be 'ambitious' for the plan company to pay off the 2029 noteholders in full but that the court did not require certainty. What was required to be demonstrated was that, on the balance of probabilities, the dissenting noteholders would be better off under the plan than in insolvency. Here in particular the court noted that even if the court were with hindsight to be found wrong on whether Condition A was met, the group would '*not miss the relevant alternative by much'*.

The court further noted that if in the future Adler were to fall significantly short of its forecasts, the noteholders would retain the right to accelerate the notes and would be highly likely to do so, forcing a pari passu distribution of all notes. Leech J did recognise that, as the existing maturity dates would be preserved under the plan (save for a 12-month extension of the 2024 notes), the 2029 noteholders would face a greater element of risk. However, he noted that the plan did not significantly change this, since they had assumed a greater degree of commercial risk when they purchased the notes. He also reiterated that the court's role was not to determine whether the plan presented was the fairest outcome – the court only needs to decide on the plan it has before it, not on whether better plans may have existed.

Pari passu
The AHG argued that, by preserving the existing maturity dates of the notes (bar the 2024 notes), the restructuring plan would violate a fundamental principle of English insolvency law: the *pari passu* principle. The AHG argued that, in the relevant alternative of a formal group-wide liquidation, all noteholders would rank alongside each other, the maturity date having been accelerated by virtue of the liquidation, whereas under the plan the 2029 noteholders would retain their temporal subordination and face further subordination to €935m new money and the 2024 notes (who were granted priority over other series in return for the maturity extension). While the AHG accepted that departure from the *pari passu* principle could be justified, they argued this should only be done to rescue the company as a going concern and not in the case of a 'liquidation plan'.

The court held that the plan did not breach the *pari passu* principle, given that the court had held that creditors would most likely be paid in full under the plan or would at least see

better returns than in the relevant alternative (see Condition A above). The court might well have been prepared to accept that the plan involved a departure from the pari passu principle if it had found that creditors would not be paid in full under the plan; it might also have found that this was unfair and a fundamental objection to the plan, but this was not the case.

Acceleration / "Blot"

A number of AHG members had, before the plan meetings took place, served acceleration notices, declaring that their sums were immediately due and payable due to the commencement of the restructuring plan proceedings. The AHG contended that the plan was defective because it did not account for this purported acceleration and therefore there was a "blot" on the plan.

Adler claimed that the acceleration notices were invalid under German law, because restructuring plans did not constitute "insolvency proceedings" under the relevant clause in the notes. The court was reluctant to decide this point, given it rested on the construction of a German language term and a German court could later reach a contrary conclusion. It was, in Leech J's judgment, unnecessary to decide whether the acceleration notices were valid because, even if they were later found to be valid, it was open to Adler to simply pay off the relevant creditors. This issue did not therefore speak to the legality or operability of the restructuring plan. However, the court did express certain reservations in this regard.

Treatment of shareholders

This point gave the court the greatest concern. The providers of new money under the plan would be rewarded with only 22.5% equity in the group's parent company. Leech J did not see any obvious reason why existing shareholders, who themselves provided no additional funding, should retain so much of the equity and the upside if the plan was successful. However, on the whole, this considerable unease was not sufficient to refuse sanction. The judge recognised that the new money providers had been able to negotiate the equity matter themselves and the specific terms they had agreed did not materially affect the dissenting noteholders' position.

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