if this email displays incorrectly or you can not see it please click here

AGPS BondCo: Court of Appeal sets aside restructuring plan sanction

Bulletin 1061

CELEBRATING 1000 TECHNICAL BULLETINS

Case: Strategic Value Capital Solutions Master Fund LP & Ors v AGPS BondCo PLC [2024] EWCA Civ 24, Nugee and Snowden LJJ, Sir Nicholas Patten, 23 January 2024

Synopsis: The Court of Appeal set aside the first instance order sanctioning Adler's restructuring plan, in the first restructuring plan to reach the Court of Appeal. The CA agreed with the appellant group of 2029 Noteholders that the plan diverged from the *pari passu* treatment that those Noteholders would receive in the relevant alternative without proper justification.

The traditional framework for the exercise of discretion in a scheme of arrangement requires modification when the court is being asked to exercise its discretion to bind a dissenting class to a restructuring plan.

Obiter - there is no power under Part 26A to extinguish claims or shareholder rights for zero consideration.

Topics Covered: Restructuring Plan, Cross-Class Cram-Down, Pari Passu Principle

Comment

The Court of Appeal overturned the judgment of the High Court in April 2023 sanctioning Adler's Part 26A restructuring plan (RP), which originally sought to exercise cross-class cram-down (CCCD) against a dissenting class of 2029 noteholders (the 2029 Noteholders).

The judgment provides useful commentary as to the framework for the court's discretion when deciding whether to sanction RPs, especially those involving CCCD, and also notable commentary on timetabling.

Snowden LJ, delivering the only substantive judgment, acknowledged that RPs "*which offer the possibility of cross-class cram down, are capable of exerting an even more formidable compulsion and potential injustice upon dissenting creditors*". The CA's main conclusions include that:

- in considering whether to exercise its discretion to sanction an RP once the statutory conditions for CCCD have been satisfied, the court cannot simply apply the conventional 'rationality test' from schemes of arrangement;
- a key issue for the court in exercising its discretion to impose a plan upon a dissenting class is to identify whether the plan provides for differences in treatment of the different classes of creditors *inter se* and, if so, whether those differences can be justified;
- an obvious reference point for this exercise must be the position of the creditors in the relevant alternative; and
- the 'vertical' and 'horizontal' comparisons (developed in the context of unfair prejudice challenges to company voluntary arrangements) can inform this analysis.

As the first appellate authority on RPs, the judgment offers significant commentary on many of the first instance authorities to date. Notably, the CA did not agree with the decision in *Re Prezzo Investco Ltd* [2023] EWHC 1679 (Ch) (Technical Bulletin 1054) that a 'give and take' requirement does not apply in respect of stakeholders who are 'out of the money' in the relevant alternative to the RP.

Following criticism of timing in the case, Snowden LJ stated that, to prevent undue delay and expense, a plan company must make relevant information available in a timely manner and parties (and their advisers) must co-operate to focus and narrow the issues for decision.

The judgment leaves various uncertainties for both Adler and RPs more generally, including:

- what justifies departure from the *pari passu* principle – both generally and specifically where an enhanced priority ('elevation') is extended to the existing claims of providers of new money;
- 'unscrambling the egg' – how RPs which have been sanctioned and implemented might subsequently be unravelled if overturned on appeal;
- potential implications if opposing stakeholders seek a stay on implementation of an RP pending the outcome of an appeal – including the circumstances in which a stay would be granted, timetable for appeals, and whether such stakeholders would be required to give a cross-undertaking (fortified by security) as a condition to the stay;
- whether substitution of the notes issuer to engage the jurisdiction of the English court is a legitimate technique (the CA expressly noted that the fact its judgment did not deal with this issue should not be taken as an endorsement of the technique for future cases); and
- what "modest" consideration will suffice to constitute the requisite "compromise or arrangement" with an "out-of-the-money" class.

The CA refused Adler permission to appeal this judgment; it is unclear at this stage whether Adler will seek permission to appeal directly from the Supreme Court.

The Facts

The facts are set out in Technical Bulletin 1029 but are repeated here for ease of reading.

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 2029 Noteholders 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%.

For the RP to be sanctioned therefore, the court was required to exercise its discretion to apply CCCD in relation to the 2029 Noteholders pursuant to s901G Part 26A Companies Act 2006.

The High Court sanctioned the RP on 12 April 2023 with immediate effect, thus allowing the RP to be implemented notwithstanding the possibility of appeal. The 2029 Noteholders issued an application for permission to appeal on 16 May 2023. The CA, while allowing the appeal to be heard, refused an application for expedition of the appeal hearing.

The appeal was brought on the following principal grounds:

(a) The differing treatment of the notes, namely the retention of the maturity dates, departed from the *pari passu* principle which would have applied in the relevant alternatively (namely a German insolvency) and placed a materially greater risk of non-payment on the 2029 Noteholders than holders of other series of the notes.

(b) In assessing the fairness of the RP as between the assenting and dissenting classes, the High Court's application of the "rationality test" was incorrect, wrongly holding that it did not need to investigate whether the RP could be better or improved.

(c) In exercising its discretion to apply CCCD, it was wrong to give weight to the fact that the RP had been approved by the other classes, and by a simple majority (rather than the required 75%) of the 2029 Noteholders. Further, it was wrong to find that the "no worse off" test being satisfied was a factor supporting the exercise of discretion, rather than a necessary precondition to exercising CCCD powers.

(d) The High Court had been wrong to accept the company's alternative case, and wrong not to accept that some of the notes had been accelerated under German law.

The Decision

Ultimately, the CA agreed with the 2029 Noteholders, overturning the sanction of the RP. Snowden LJ found that the principles relevant when considering whether to sanction a scheme of arrangement (as summarised in *Re Noble Group Limit*ed [2018] EWHC 2911 (Ch) (Noble) Technical Bulletin 837) need to be modified in the context of RPs, especially those involving CCCD. The following main points can be made:

1. *Different treatment of creditors in the relevant alternative than under the plan*: By retaining the staggering of maturity dates of the notes, the RP deviated from the *pari passu* distribution of assets which would otherwise be applied in the relevant alternative where unsecured creditors would be paid *pro rata* from the realisations of the Group at the same time. Under the RP, payment to the 2029 Noteholders at a time which would be significantly later than payment made to the other noteholders put the 2029 Noteholders at risk of being paid a substantially lower amount than that which would be received by the other noteholders under the RP due to the passage of time, value risk of the assets and likelihood that the Group would simply run out of money by 2029: "*sequential payments to creditors from a potentially inadequate common fund of money are not the same thing as a rateable distribution of that fund*".

   The CA held that, to permit a deviation from treating creditors the same under a plan than they would be treated in the relevant alternative, the court needs to be persuaded that there is a good and proper justification for such departure. The court provided examples of when such a departure might be justified (e.g. creditors providing an additional benefit or accommodation to assist the achievement of the RP in the interests of creditors as a whole (i.e. by providing new money), or trade creditors or employees being paid in full (to allow for the continuation of the business)). Here, however, there was no good reason or proper basis for the RP to adhere to the sequential payments in accordance with the maturity dates of the notes, and any reasons given were not sufficient to overcome the fundamental unfairness of an unjustified departure from the *pari passu* principle. Conversely, the treatment of the 2024 noteholders (namely granting priority of payment in return for a one year deferral in maturity dates) which also involved a deviation from their treatment in the relevant alternative was justified.

2. *Fairness and rationality*: when considering whether to impose CCCD on a dissenting class, the court should not apply the rationality test that assesses fairness based on the overall level of voting across assenting and dissenting classes as a whole, nor should the court look to the "*intelligent and honest man*" test to impose terms on dissenting creditors whose class interests are different to those of assenting classes. Rather, the court must engage with the underlying commercial issues.

3. *"Fairer plan"*: "*exercise of a judicial discretion to alter the rights of a dissenting class for the perceived benefit of the assenting classes necessarily requires the court to inquire how the value sought to be preserved or generated by the restructuring plan, over and above the relevant alternative, is to be allocated between those different creditor groups*." The CA held that the parties could "*easily*" have produced a fairer plan by agreeing to harmonise the maturity dates.

4. *Horizontal and vertical comparisons:* applying the approach adopted in company voluntary arrangements, the court considered it appropriate to conduct a horizontal comparison in a CCCD scenario, requiring any differences in treatment of classes of creditors *inter se* to be justified – there should be a fair distribution of the benefits of the RP, over and above the relevant alternative, between those classes who have agreed the RP, and those who have not. There needs to be a "*compelling reason*" to persuade the court to sanction an RP which allocates the benefits differentially between classes of similar standing in a material respect without justification.

   As for the vertical comparison, satisfaction of the conditions to CCCD under s901G Part 26A is merely a jurisdictional threshold and does not give rise to a presumption in favour of CCCD and sanction; the court must still consider whether to exercise its discretion in light of all the relevant factors and circumstances.

Other points to note

- *Timetabling:* The issue of timetabling is not new, but a continuation of pressures which have long been acknowledged by the court in relation to schemes of arrangement, highlighted by Snowden J (as he then was) in *Noble*. However, the issue is accentuated by CCCD where the risk to fairness is greater. While the judgment recognises the need for urgency in certain cases, "*the court's willingness to decide cases quickly to assist companies in genuine and urgent financial difficulties must not be taken for granted or abused… sufficient time for the proper conduct of a contested Part 26A process must be factored into the timetable*".

- *Disclosure:* Although inadequacy of the explanatory statement was not advanced as a separate ground of appeal, the CA's judgment noted that Adler's explanatory statement was "*(to say the least) considerably less informative than it should have been in a number of critical respects*" and accepted that the inadequacies "*fatally undermined*" any confidence that the court could have in the fact that certain 2029 Noteholders supported the plan. In particular, the explanatory statement ought to have made clear that the effect of making payment in accordance with sequential maturity dates was to place a greater risk of non-payment on the 2029 Noteholders than the earlier series of notes.

- *"Give and take"*: Provisionally, the CA noted (*obiter*) that there is no jurisdiction under Part 26A to sanction a compulsory cancellation or transfer of shares for no consideration. As noted, it did not agree with the reasoning in *Re Prezzo* to the effect that Part 26A introduces a power to extinguish claims or confiscate shares for no consideration.

Post script

In *Re Link Fund Solutions* [2024] EWHC 250 (Ch) – a scheme of arrangement case with judgment handed down on 9 February 2024 – Richards J granted sanction of the proposed scheme but decided not to seal the order until 29 February 2024 in order to give parties a chance to digest the judgment and permit time for permission to appeal to be sought. While not itself referencing *Adler* it is clear that the procedural guidelines noted in the Court of Appeal judgment already have implications on timetabling of first instance judgments.

The views expressed in this Technical Bulletin do not necessarily reflect those of individual members of the Technical Committee, or the members of the Insolvency Lawyers' Association as a whole.

"A front office approach to a back office service" independent Agent and Trustee of choice - principal sponsor of the ILA.

If you wish to be removed from the ILA mailing list and not receive any further updates please click here