SLAUGHTER AND MAY/

CLIENT BRIEFING

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WHAT DO(N'T) WE KNOW ABOUT RESTRUCTURING PLANS AFTER ADLER?

When Part 26A of the Companies Act was introduced in 2020, the Government deliberately modelled the legislation on Part 26, with the view that the new regime (and the advisers and judges seeking to navigate it) would benefit from piggybacking on over a century's worth of case law relating to schemes of arrangement.

However, Part 26A is fundamentally different to Part 26. A Part 26 scheme of arrangement is, at its heart, a form of collective decision making in which the Court is asked to bless the commercial decision of the majority of each class of creditor and/or shareholder. By contrast, Part 26A - through the introduction of cross-class cram down - introduces a far more extensive jurisdiction for the Court to impose a transaction on a dissenting class. While the Part 26A legislation sets out two jurisdictional conditions for the use of this power (Condition A, being that none of the members of the dissenting class can be worse off through the plan than in the "relevant alternative" (defined as whatever the Court considers would be most likely to occur in relation to the company if the restructuring plan were not sanctioned), and Condition B, requiring that at least one "in the money" class has voted in favour), neither the legislation nor the accompanying guidance gives the Court a clear steer on how they should exercise their discretion with respect to it.

Adler (AGPS Bondco [2024] EWCA Civ 24) is the first Part 26A case to reach the Court of Appeal and confirms, if any doubt existed, that - although on its face aspects of the statutory framework are very similar - the new regime is fundamentally different, both in substance and procedure, to Part 26.

Whilst a number of points have now been helpfully clarified in relation to a power which the Court of Appeal describes as being "capable of exerting … formidable compulsion and potential injustice", and there is now greater clarity on the procedural conduct of Part 26A restructuring plans, a significant number of questions still remain regarding the key issue of how the Court should exercise its discretion to approve cross-class cram down.

THE FACTS

The basic facts can be restated quite briefly. Adler is a German real estate business with (prior to the restructuring) multiple series of unsecured, *pari passu*, bonds, all governed by German law, with a range of maturities, from 2024 (the **2024 Notes**) to 2029 (the **2029 Notes**). Facing a liquidity crisis, the group negotiated a restructuring with a Steerco of noteholders failing which the group would enter into insolvency, and all the noteholders (irrespective of the original maturity of their instrument) would have equal ranking unsecured claims.

To avoid this outcome, the restructuring proposal that was agreed was for the Steerco to provide approximately €900m of new secured debt to repay near term debt maturities and create a runway for a controlled wind-down of the business. Among other things, the new money providers would receive 22.5% of the equity in the group (with the remainder staying in the hands of the existing shareholders). In order to create additional breathing room, the 2024 Notes would also have their maturity extended to 2025, and in exchange would become secured. All other notes would otherwise retain their existing maturity dates and ranking.

When a consent solicitation seeking approval for the restructuring failed due to a blocking vote cast by 2029 Noteholders, the Group then moved to implement the same deal via Part 26A (manoeuvring into the jurisdiction through the substitution of an English issuer). This attempt has been consistently challenged by certain holders of the 2029 Notes, in both England and Germany. Multiple legal arguments have been deployed (many of which have not received full consideration at either stage in the legal proceedings). However, the underlying commercial complaint motivating the opposition is that the combination of actual subordination imposed on the 2029 Notes (by

way of the introduction of secured new money and the grant of security to the 2024 Notes), and the maintenance of the last-in-time maturity of the 2029 Notes, meant that – if the run-off did not go to plan and asset recoveries fell short of expectation - the 2029 Noteholders were exposed to a real risk of seeing other *pari passu* noteholders being paid out whilst they waited at the back of the line for what may, by the end, be quite slim pickings.

DISCRETION - WHAT IS CLEAR?

"Limited Rationality" when cross-class cram down not engaged

In cases where cross-class cram down does not apply (because there is no dissenting class), then the approach of the Court to sanction is the same "limited rationality" review as applies in Part 26. In Part 26 the Court asks – in the classic formulation – whether the scheme is one that "an intelligent and honest man, a member of the class concerned and acting in respect of his own interest, might reasonably approve". However, the Court almost invariably relies heavily on the very fact of the majority vote in favour in answering that question. Although in recent cases judges have increasingly undertaken what has been described as a 'fairness cross-check' to ensure the position of creditors is no worse than under the relevant counterfactual, that is a relatively light-touch inquiry, unless there is reason to doubt that the majority vote was not achieved solely because the majority considered the plan fair for the class. The Court does not impose its own commercial views and does not consider whether there could be another, fairer plan.

Is there a fair allocation of the benefits of the restructuring when cross-class cram down engaged?

However, where cross-class cram down does apply, then the Court cannot simply apply the rationality test in the same way. The underlying principle justifying the rationality check in Part 26 is that it is fair to impose a scheme on a dissenting minority within a class because the members of that class have a "commonality of commercial interests" based upon a sufficient similarity of rights. By contrast, in Part 26A a dissenting class will, by virtue of it having been placed in a different class, have materially different commercial interests to the assenting classes. Accordingly, it cannot make sense to assume that it is fair to impose a transaction on that group simply because other groups, with different commercial interests, have approved it. Instead, where there is a dissenting class, the Court needs to consider whether there is a "fair distribution" of the benefits created by the restructuring. The longstanding analytical techniques used in respect of CVAs, and increasingly adopted at the fairness cross-check stage in schemes of arrangement (requiring a comparison of a dissenting creditor's position "vertically" against other similarly placed creditors if the restructuring does not go ahead, and "horizontally" against the position of other creditors does go ahead), should also be adopted in Part 26A, but this is a much more detailed inquiry than in a Part 26 context. Crucially, it may include considering whether there is a fairer or better plan, as it does in a CVA context but not in a Part 26 scheme. In doing all this, the judgment in Adler makes clear that the Court is required to engage with the "underlying commercial issues".

Pari passu

The Court of Appeal has also confirmed that, where the relevant alternative to the restructuring is a liquidation proceeding, then the *pari passu* priority of unsecured creditors must be complied with unless there is a good reason for not doing so. This finding is made notwithstanding the fact that the existence of this rule as being a fundamental part of Part 26A is not made clear in the legislation or the accompanying guidance material, and that there is (deliberately) no version of the Absolute Priority Rule (**APR**) found in Chapter 11 in Part 26A. In Adler the Company does not appear to have offered any commercial justification for maintaining the existing maturity dates notwithstanding that the plan was to wind the company down over time. Of course, if the plan were to continue to trade the business in the hope that it would grow back into its capital structure, there may be very good reasons for departing from a *pari passu* structure, notwithstanding that the relevant alternative was a liquidation or administration proceeding.

No expropriation

It is now clear that Part 26A cannot be used to expropriate an out of the money class. There must be some element of give and take. The Court of Appeal refers to a "modest amount" of compensation. It remains to be seen how judges will approach this in practice.

Treatment of equity

Adler confirms that if a Part 26A restructuring plan is used to impose a deal on a non-consenting class of creditors, and given there is no APR, there is no requirement that shareholders' equity is written down or expropriated. However, and as explored below, the

parameters setting out when shareholders may retain their equity remain unclear.

DISCRETION - WHAT IS LESS CLEAR?

Narrow basis of decision

The judgment of the Court of Appeal suggests it would have been quite straightforward for the Group to present a compliant restructuring plan – simply align the maturities. Since they were not so aligned, and because the Company offered no justification for retaining the original maturities, there was then a relatively straightforward basis to uphold the appeal. Although the Court of Appeal decision rests on this relatively narrow point, it leaves behind much more significant implications for how Part 26A restructuring plans should be conducted going forward. However, in some key respects it does not provide guidance to first instance judges on how they should address those implications.

What is a "fairer or better plan"?

The heart of the difficulty is found in the point that the Court of Appeal has held that a first instance judge must, when applying cross-class cram down, ask itself if there is a fairer or better plan and in so doing engage with the "underlying commercial issues". By way of example, and in the context of considering whether a departure from the *pari passu* principle might be justified, the Court of Appeal mentions that it might have been open to the Court to find that the grant of security to the 2024 Notes was "a proportionate response" to their maturity extension. Similarly, the Court of Appeal mentions the common scenario in which the existing debt claims of new money providers are "elevated" as part of the consideration for the new money, and notes that may be justified, but the assessment of it would be "highly fact sensitive".

However, even on the facts of this case, deciding whether the deferral of the maturity of the 2024 Notes might have justified the grant of security is not straightforward. It is also not clear whether one of the "underlying commercial issues" that the Court might take into account should be statements regarding creditor support – for instance, and as is not uncommon, if dissenting creditors have a "fairer" plan but this relies on the provision of new money that they cannot entirely fund, can a steering group effectively railroad this requirement by saying they would not support it? To what extent then should the Court weigh the feasibility of the fairer and better plan?

How does the Court exercise its discretion?

The key question for Part 26A restructuring plans going forward is therefore – how should the Court exercise its discretion in the context of cross-class cram down? It is certainly clear that the analysis must be done by reference to the relevant alternative, and this judgment highlights yet further how important the supporting evidence for that analysis is. Going beyond that, it is also clear that the Court must assess whether there is a fair distribution of the benefits of the plan, which may include asking whether there is a fairer or better plan, and must carry out a vertical and horizontal comparison of the treatment of dissenting creditor classes. However, and the reason why it is not hard to imagine that Part 26A may return to the Court of Appeal before too long, the first instance Courts are not given tangible guidance on how that exercise should actually be carried out, and how these relatively abstract principles should be applied.

Treatment of equity (again)

It is possible that the view expressed in this case that it is acceptable for the shareholders to retain 77.5% of the equity is confined to these facts - that is, a wind down scenario in which equity will only ever receive a return once all creditors have been paid in full, and where there is no long-term going concern value of the business to be captured. That does however leave open the question of whether, if the proceeds generated by the wind-down outperformed expectations resulting in a recovery for shareholders, holders of the 2029 Notes would have received appropriate compensation for being required to take the risk of the longer wind-down plan that enabled the shareholders to make that recovery.

And, going beyond that, although retention of the equity in this case did not appear to have given the Court of Appeal as much cause for concern as it gave the judge at first instance, no real guidance is given as to how the Court should address the scenario where shareholders intend to retain their equity in circumstances in which creditor rights are being impaired - where should the line be drawn?

That the Court of Appeal fails to give guidance on these points is understandable as it fundamentally based its decision on the breach of the *pari passu* rule. However, it does suggest that the higher Courts may need to engage with Part 26A again when different fact patterns present different issues.

PROCEDURAL LESSONS

Poor planning on your part does not necessitate an emergency on mine

In terms of procedure, the days of a contested restructuring plan hearing being treated procedurally as akin to a slightly longer Part 26 scheme sanction hearing seem to be over. We are now in a world where the Court of Appeal has made it very clear that - in cases where the driver for the restructuring is a scheduled maturity date, or indeed anything other than an unforeseen (or unforeseeable) liquidity crisis - it will expect a proper process and timetable to be complied with (including full compliance with the Practice Direction). In particular:

- Interested parties should be given adequate time to prepare for hearings, and the Court should similarly be given appropriate time to hear the case and give a reasoned decision;
- the plan company must, subject to any necessary confidentiality undertakings, make available in a timely manner the relevant material that underlies the valuations upon which it relies;
- parties, advisers and experts must cooperate to focus and narrow the issues for decision so that sanction hearings are confined to manageable proportions; and
- if sensible agreement is not forthcoming, the Court should exercise its power to order specific disclosure of key information and its other case management powers robustly.

What is described here is starting to look very similar to serious commercial litigation.

Appeals

It is also now clear that, if a party is intending to appeal a restructuring plan which has been sanctioned, and wishes to avoid the risk of the restructuring becoming effective before the appeal can be heard, it is necessary to seek an undertaking from the company not to register the order with Companies House (or, failing that, seek an order from the Court prohibiting it being registered pending a decision on the appeal). Otherwise, as may well be the case here, victory on appeal might be what is referred to in Chapter 11 as "equitably moot". Although it appears that the plan company in Adler had not argued that, because the plan had been made effective and the new money drawn down and utilised, the appeal itself was moot, Adler's response to the reversal at the Court of Appeal was simply that, while it "respects the decision of the Court of Appeal", the "implementation of the restructuring in April 2023 was carried out in accordance with German law and therefore the terms and conditions of the bonds remain valid regardless of the decision by the Court of Appeal to set aside the Sanction Order".

CONCLUSIONS

- Unless there is a genuine crisis, formal timetables for restructuring plans will need to expand and the Court can be expected to play a more interventionist role. This is already the case in the US as part of Chapter 11 processes. Whilst the decision provides more clarity on some topics, there are certain judges in England that will inevitably have more or less experience of restructuring and insolvency processes so the approach taken may continue to differ on some issues.
- As a result of the continued shift to a litigation style approach and mindset, it will be prudent for more work to be frontloaded before the formal plan timetable to ensure that the evidence supporting the plan is robust.
- Given the uncertainties that remain around how the Court should apply its discretion when authorising cross-class cram down, or when deciding what proportion of the equity it is acceptable for shareholders to retain, it is clear that the nature and extent of the evidence needed to support the exercise of that discretion is going to continue to increase and evolve. In particular, this will mean robust valuation and relevant alternative evidence, as well as fallback plans to be able to pivot towards producing more detailed or supplemental evidence, if required. Careful thought should also be given to the individuals at the company and from the advisory team that will provide evidence and how they will adapt to challenge and cross-examination.
- Significant caution should be exercised when attempting to use a Part 26A restructuring plan as an alternative implementation technique for a commercial deal where a consensual approach has failed - unless of course that deal

is either originally built around the parameters of Part 26A, or is adjusted appropriately.

- Because the appeal focused on the *pari passu* analysis, other aspects of Adler which might have been fought over (such as issuer substitution, or the international effectiveness of the plan) were sidelined. However, the Court of Appeal was clear that - simply because it had not considered these points, it should not be taken to have endorsed a particular approach.

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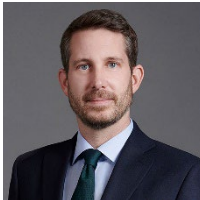

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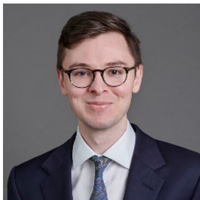

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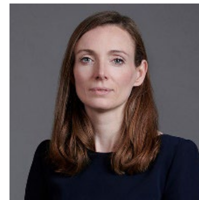

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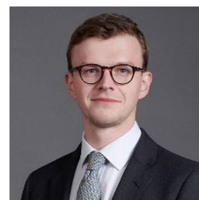

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