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UK Company Restructuring Plans: What Is Next After *Adler*?

By Clare Tanner, Jonathan Lawrence and Maya C. Ffrench-Adam*

In this article, the authors examine the implications of a recent decision by the England and Wales Court of Appeal on restructurings under UK law.

The England and Wales Court of Appeal recently handed down its first judgment relating to a restructuring plan under Part 26A of the UK Companies Act 2006: Re AGPS Bondco Plc [2024] EWCA Civ 24. Restructuring plans were a 2020 innovation in UK insolvency law. At first instance, the judge had exercised his discretion to sanction the restructuring plan and effected a cross-class cramdown (CCCD) of creditors. The appeal against the first instance decision was made by dissenting creditors and was allowed by the Court of Appeal. The lead judgment of Lord Justice Richard Snowden will inform debtors, noteholders, trustees and other participants in financial structures or restructurings when formulating or responding to Part 26A plans.

However, uncertainties remain.

BACKGROUND

In the autumn of 2022, the Adler Group (the Group), the owner of a large portfolio of residential real estate in Germany, was facing significant financial difficulties. The Group's indebtedness included a series of senior unsecured notes (the Notes) issued by Adler Group SA (the Parent Company), a Luxembourg company. The six series of the Notes had a range of maturity dates from 2024 to 2029, and each series ranked equally.

The Group proposed a controlled wind down of its business with a view to achieving better realizations than in an immediate formal insolvency process. The proposals included an injection of new money, with the new money providers receiving 22.5% of the equity in the Parent Company, the extension of the maturity dates of the 2024 Notes by a year, and the modification of the negative pledge clauses in the Notes. This modification was to facilitate an amendment of the enforcement waterfall, with the new money ranking first followed by the 2024 Notes and with the remaining series of Notes ranking junior to the 2024 Notes.

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The proposed alteration of the terms and conditions of the Notes was to be implemented by a consent solicitation process. However, there was a failure to achieve the requisite majority in relation to the 2029 Notes. The Group proposed a UK restructuring plan (the Plan). AGPS Bondco PLC (the plan company) was incorporated in England and Wales and substituted for the Parent Company as the Issuer of the Notes in order to engage the jurisdiction of the English Court (the Issuer Substitution).

At separate class meetings of the holders of each series of Notes (each, a Plan Meeting), the Plan was approved by majorities in excess of 75% of those voting at each Plan Meeting, save for the meeting of the 2029 Notes, which fell short of the required 75% majority. At the sanction hearing, the first instance court was satisfied that: (A) none of the members of the dissenting class would be any worse off if the Plan were sanctioned than in the relevant alternative (in this case, a formal insolvency process), and (B) the Plan had been approved by a class that would receive a payment or have a genuine economic interest in the company in the event of the relevant alternative. The judge at first instance determined that conditions A and B were met and exercised his discretion to sanction the Plan. Dissenting 2029 noteholders appealed.

KEY CONSIDERATIONS ARISING FROM THE COURT OF APPEAL'S JUDGMENT

Discretion to Sanction a Plan Where CCCD Is Not Engaged

The established principles guiding a court in the exercise of its discretion to sanction a scheme of arrangement (under Part 26 of the UK Companies Act 2006) apply in relation to a restructuring plan where there is no requirement for CCCD.

The court must consider:

(i) Whether the provisions of the legislation (including questions of class composition, whether statutory majorities were obtained, and the adequacy of the explanatory statement) have been met;

(ii) Whether the class was fairly represented at the meeting and without coercion of the minority by the majority to promote interests adverse to the class;

(iii) Whether it is a fair plan that an intelligent and honest creditor could reasonably approve (the rationality test); and

(iv) Whether there is any defect that would make the plan unlawful or otherwise inoperable.

The court does not need to establish whether the scheme is the only fair scheme or the best scheme.

Discretion to Sanction a Plan Where CCCD Is Engaged

Where the court is being asked to impose a restructuring plan upon a dissenting class, the approach under Part 26 continues to apply but requires modification. The court has to be satisfied in regard to each assenting class that those who attended and voted in favour were a true reflection of the class as a whole (which might not be the case if turnout were very low) and that the majority had not voted to coerce the minority. This is of particular importance when the court is considering the class with a genuine economic interest whose affirmative vote is relied upon to satisfy condition B as stated above.

For a dissenting class, the court should not apply a rationality test based on the level of voting in assenting classes or the overall value of affirmative votes across the assenting and dissenting classes as a whole. A 'vertical' comparison (comparing the position of the dissenting creditors under the Plan with the position of the dissenting creditors in the relevant alternative) has to be carried out in order to establish that condition A (the no worse off test) is satisfied, but this does not give rise to a presumption in favor of sanction.

The court should conduct some form of "horizontal" comparison (comparing the position of the dissenting class with the position of the other classes if the restructuring goes ahead) and consider whether differences in treatment of creditors, inter se, are justified. The reference point for this analysis is the position of the creditors in the relevant alternative (for example, a formal insolvency). Where no justification is given, it will take a compelling reason to persuade the court to sanction the plan. Further, the court must inquire how the value to be preserved or generated by the restructuring plan over and above the relevant alternative is to be allocated between the different creditor groups. When considering whether the allocation of the assets is fair, the court should ask whether a different allocation would have been possible and fairer.

Pari Passu Distribution

Where the relevant alternative is a formal insolvency, in which the claims of all plan creditors would rank equally for pari passu distribution, the court will normally approve a plan replicating that pari passu distribution in relation to the benefits of the restructuring. A departure from such pari passu distribution is permissible provided that it is justified by a good reason or a proper basis. It is likely to be justifiable that creditors who provide some additional benefit to assist the restructuring in the interests of creditors as a whole are entitled to receive some priority or enhanced share of the benefits. The analysis is likely to be highly fact sensitive but, for example, creditors who provide new money to facilitate the restructuring may be entitled to receive full repayment of the new money in priority to preexisting creditors or possibly some enhanced priority (elevation) in relation to their existing claims.

There might be no justification for elevation of existing debt if, for example,

(i) The opportunity to provide new money was not available on an equal and noncoercive basis to all creditors;

(ii) If the new money was provided on more expensive terms than that available in the market; or

(iii) If the extent to which the existing debt was elevated was disproportionate to the extra benefits provided by the new money.

The Court of Appeal decided that the provisions of the Plan under which the different series of Notes would be paid sequentially on their original maturity dates (or, in the case of the 2024 Notes, one year later) involved a departure from the pari passu principle because there was no assurance that sufficient sums would be realized by the Group to pay all of the noteholders in full. The Plan carried the risk that the earlier-dated Notes would be paid in full but the Group would run out of money before being able to pay the 2029 Notes. In short "the sequential payment to creditors from a potentially inadequate common fund of money was not the same thing as a rateable distribution of that fund." There was no good reason for such sequential payments. Whilst, the enhanced priority given to the 2024 Notes involved a departure from the pari passu principle, this was not the determining factor. The continuation of credit by the 2024 noteholders justified an elevation of their claims above other creditors.

Shareholder Rights

The Court of Appeal decided that the Plan was not unfair because the shareholders of the Parent Company retained their shares (albeit diluted by the new shares issued to the providers of the new money under the restructuring) even though the 2029 noteholders continued to bear the greatest risk of nonpayment.

In his judgment, Lord Justice Snowden indicated that there is no jurisdiction under Part 26A to confiscate or expropriate shareholder (or creditor) interests for no consideration. Some element of give and take is required and paying a "modest amount" of compensation should not unduly impede the restructuring process.

Cross-Border Considerations

Without expressing a view, Lord Justice Snowden indicated that this decision did not amount to an endorsement of Issuer Substitution in future cases.

Practical Considerations

Timetable

The Court of Appeal emphasized that the court's willingness to decide cases quickly to assist companies in genuine and urgent financial difficulties should not be taken for granted or be abused. In the case of a foreseeable deadline, sufficient time for a contested Part 26A process and full compliance with the relevant practice statement must be factored in.

Disclosure and Cooperation

To prevent undue delay and expense, a plan company must make available the material underpinning valuations in a timely manner. If not, the court should exercise its power to order specific disclosure. Parties and their advisers and experts must cooperate to narrow the issues which the court has to decide at the sanction hearing.

Stay

To prevent a restructuring plan from becoming effective prior to the outcome of any appeal, it is necessary for the appellant to apply for a stay. Alternatively, the appellant can apply for a direction that the order should not be delivered to the Registrar of Companies (at which point it becomes binding on the company and all affected creditors or members) pending an appeal.

In response to the Court of Appeal's decision, the Parent Company announced that it will continue its restructuring path as planned and that the implementation of the restructuring in April 2023 was carried out in accordance with German law and remains valid. In future and particularly in cross-border situations, appellants may demand undertakings not to deliver the order to Companies House pending any appeal.

COMMENT

The *Adler* decision has provided some welcome clarity for debtors, noteholders, and other stakeholders as to the principles applicable when formulating or responding to a Part 26A plan, particularly where CCCD is likely to be engaged. Parties pursuing a consent solicitation or other consensual mechanism but anticipating, in the alternative, the use of a Part 26A plan will want to have these principles in mind, ideally at the outset.

The practical application of the principles elucidated by the Court of Appeal will be a matter for future judgments. Uncertainties remain as to matters such as the effectiveness of Issuer Substitution and the level of compensation which "out of the money" creditors or shareholders should receive on the confiscation of their shares or extinction of their debts.

In the meantime, the complexity of the issues, such as the need to consider horizontal comparisons and whether there is a fairer or better plan, and the associated evidence suggests that UK restructuring plans will give rise to increasingly heavyweight litigation. Save in the case of unexpected urgency, parties must factor in sufficient time to comply with the Part 26A process and allow the court adequate time to consider the application and give judgment.