Evolution of the super scheme

FÜRST GROUP RESTRUCTURING PLAN SANCTIONED

DLA PIPER

In brief

Following the second longest sanction hearing in restructuring plan history, and the only sanction hearing yet to morph into a second convening hearing, the Part 26A restructuring plan proposed by Project Lietzenburger Straße Holdco S.à.r.L (**plan company**) has been sanctioned.[1] The plan is part of a highly contested, complex, cross-border restructuring of more than EUR1 billion of debt documented under German law.

It involved

- accessing the UK Super Scheme regime via a COMI shift;
- a comprehensive balance sheet recapitalisation, including the provision of a new super senior facility to address liquidity and cost overruns associated with the project;
- an innovative bridge funding structure provided by existing senior creditors to provide urgent liquidity to stabilise the plan company prior to completion of the restructuring;
- a reset of senior debt maturities; and
- cancellation of "out of the money" subordinated debt instruments.

These measures and the successful completion of the plan company's landmark Part 26A restructuring plan, now stabilises the Group's financial position and will permit the Group's redevelopment project on the Ku'damm to recommence.

Key takeaways from the case are:

Out of the money creditors can be excluded from voting and are not entitled to share in the restructuring surplus

First used in *Smile Telecoms*[2], Section 901C(4) of the Companies Act 2006, allows out of the money creditors to be excluded from voting on a plan. The subordinated creditors in the plan company's case were convened to vote initially, but following findings at the sanction hearing that they were out of the money, were excluded under section 901C(4) and did not participate in the second vote (on a modified plan, needed due to the Court of Appeal's comments in *Adler*[3] on give and take requirements). Exclusion of out of the money creditors from voting requires robust valuation evidence but can be a powerful tool. This case also confirms that while out of the money creditors must be given modest compensation for the cancellation of their debt, they cannot complain about how in the money creditors choose to share the restructuring surplus.

What can we learn from this case?

- Consider use of section 901C(4) and section 901F to **disenfranchise out of the money creditors from voting**
- **COMI shifting is effective**
- Ensure the proposal contains an **element of give and take** for every creditor class.
- **Modifications are possible**
- Any creditor wishing to challenge the plan company's valuation needs to **put forward its own valuation evidence**.

DLA Piper acted for the plan company in this case.

1 Re Project Lietzenburger Straße Holdco S.à.r.L [2024] EWHC 468 (Ch) and Re Project Lietzenburger Straße Holdco S.à.r.L [2024] EWHC 563 (Ch)

2 Re Smile Telecoms Holdings Limited [2022] EWHC 387 (Ch)

3 Re AGPS BondCo PLC [2024] EWCA Civ 24

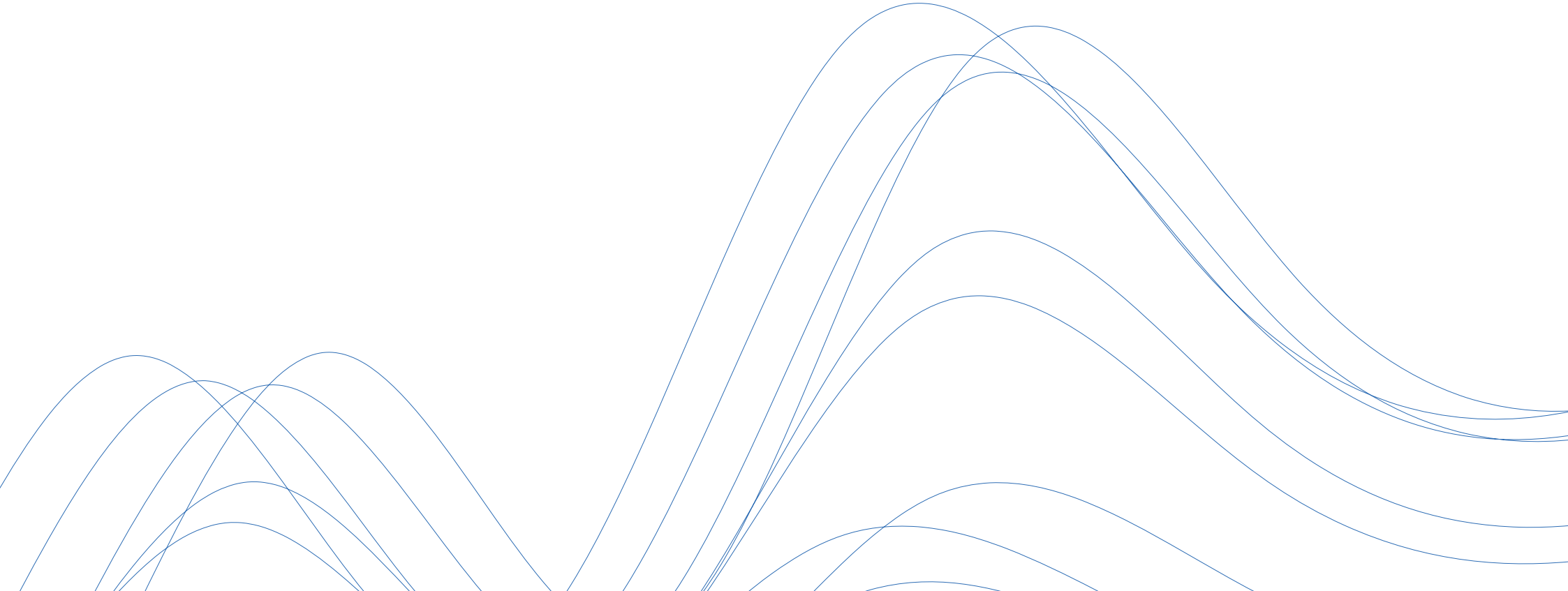
COMI shifting works

A COMI shift of the plan company carried out to establish sufficient connection and facilitate recognition in Germany and Luxembourg was found to be effective. Forum shopping is possible where there is a sound commercial and legal basis, and it is not abusive. Issuer substitution and co-obligor mechanisms are alternatives, which have been used on several occasions. The issuer substitution used in *Adler* wasn't contested, but the Court of Appeal said that its silence on the issue should not be taken as endorsement of the technique. It may therefore be tested by the courts in future. COMI shifting is not always possible, but where such a technique is accessible, debtors can have confidence that it will work to create the necessary jurisdiction to access the powerful features of the Super Scheme.

Dissenting creditors wanting to challenge valuation must provide their own evidence

In *Smile Telecoms*[4] the sanction judge said that those wishing to challenge valuation evidence on the outcome in the relevant alternative "*must stop shouting from the spectators' seats and step up to the plate*", attending the hearing and putting forward their own valuation evidence. This case provides another demonstration of the need to do that. The dissenting creditors here stepped up to the plate, they attended and raised their arguments at the sanction hearing, but failed to swing, they didn't provide any expert evidence of their own to challenge the plan company's. The Judge therefore accepted the plan company's evidence that the subordinated creditors would receive nothing in the relevant alternative.

4 Re Smile Telecoms Holdings Limited [2022] EWHC 740 (Ch)



The Plan

Total secured debt

Exceeding EUR1 billion with debt documents governed by German law.

Key asset

A development site on Kurfürstendamm a well-known shopping boulevard in Berlin. Held by Project Lietzenburger Straße PropCo S.à.r.L., a subsidiary of the plan company.

Plan company

Project Lietzenburger Straße Holdco S.à.r.L (incorporated in Luxembourg). A guarantor of the secured debt.

Claims against the borrowers could be compromised under the plan

The plan company assumed obligations under a deed of contribution so that the borrowers would have rights of contribution against it as if it were a joint principal obligor. This created a risk of "ricochet claims" against the plan company if plan creditors claimed against the borrowers, which meant claims against the borrowers were closely related to claims against the plan company and could be compromised under the plan.

Financial difficulties

Difficulties arose due to substantial cost overruns in the development of the site. Cash was held in a blocked account controlled by the senior creditors. Secured debt fell due in November 2023 and the Group was unable to pay.

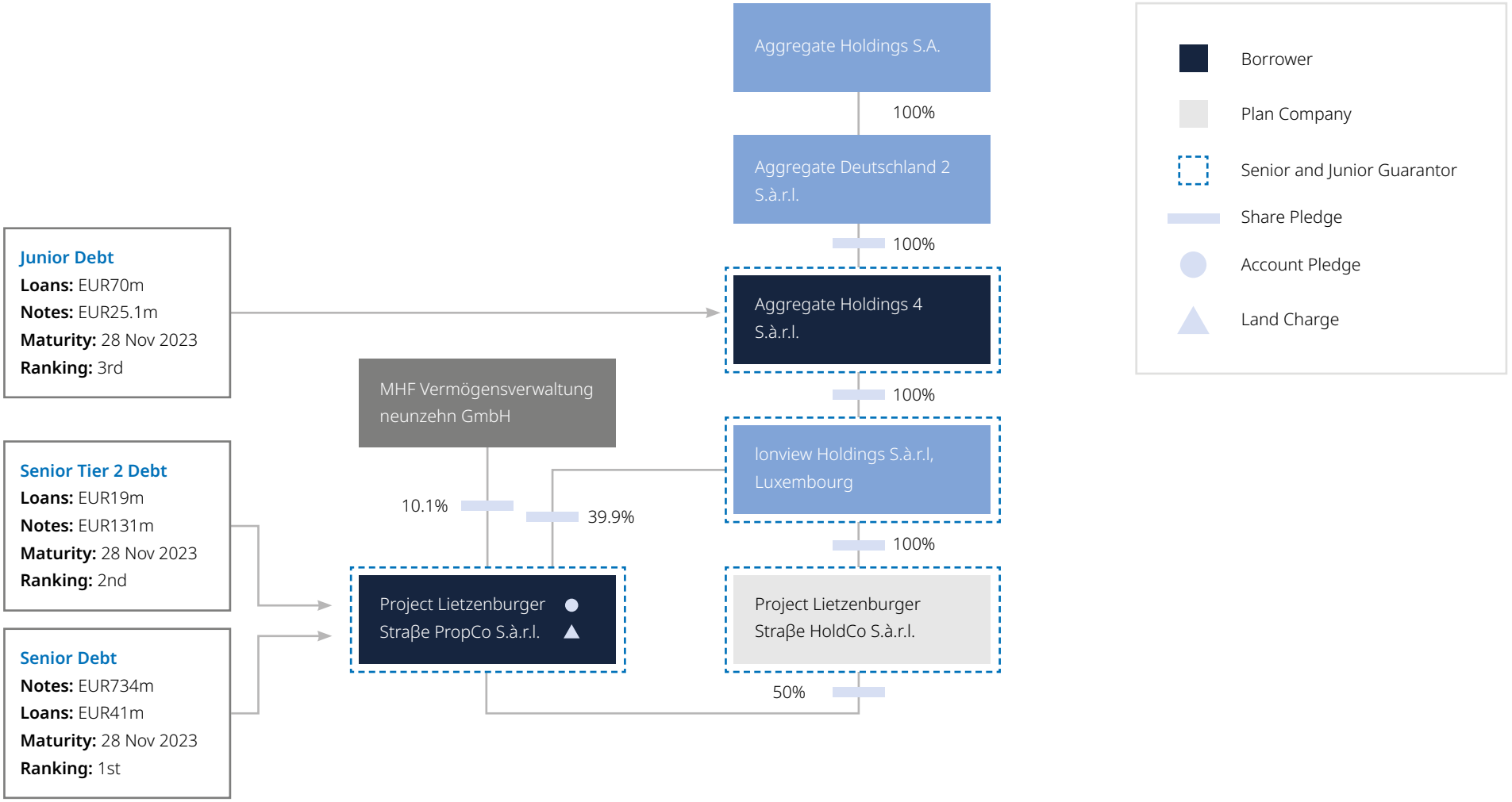
Purpose of the plan (as argued by the plan company)

To restore the Group to solvency by: (i) restructuring the Group's secured debt; and (ii) enabling the provision of new money to allow the completion of the development.

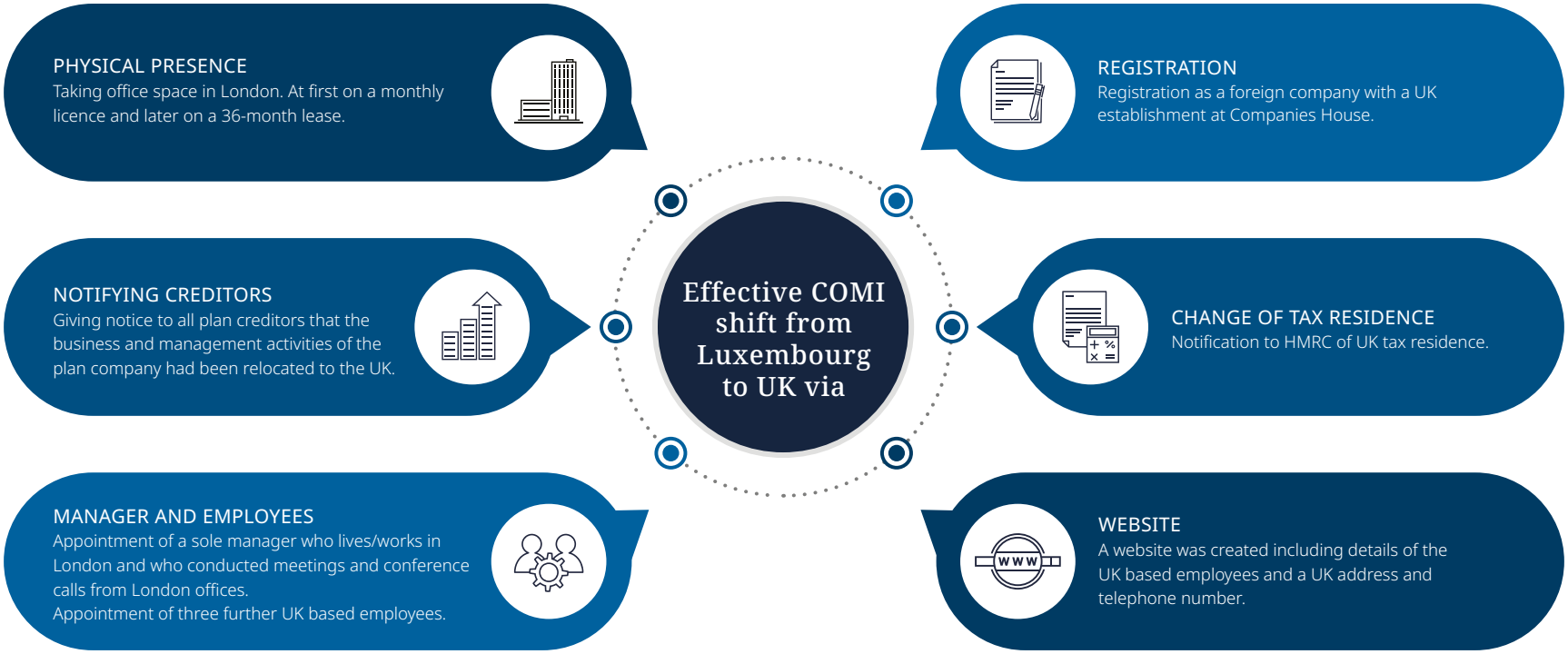
CREDITOR CLASS	COMPROMISE OR ARRANGEMENT PROPOSED	EST RELEVANT ALTERNATIVE RETURN	VOTED IN FAVOUR?
Senior Debt EUR775 million	• Entitled to participate in new EUR190 million super senior tranche • Elevation incentive for those participating in the super senior tranche giving enhanced priority and a higher interest rate for a portion of the creditor's senior debt • Extension of maturity date • Various fees payable	~45%	✓
Tier 2 Debt EUR150 million	• Pre-modification: all debt cancelled with no compensation • Post-modification: all debt cancelled and share in a fund of EUR150,000	NIL	Approved at the meeting but only 10.67% of holders voted which was not a fair representation of the class, so treated as dissenting
Junior Debt EUR95 million	• Pre-modification: all debt cancelled with no compensation • Post-modification: all debt cancelled and share in a fund of EUR50,000	NIL	✗

The Tier 2 Debt and the Junior Debt are together referred to as the **subordinated debt** and the creditors holding such debt as the **subordinated creditors.**

The Group pre-restructuring



COMI shift required to establish connection and enable recognition



COMI = the place where the [plan company] conducts the administration of its interests on a regular basis and which is ascertainable by third parties.

Recognition

Overall finding on recognition: There was a reasonable prospect that the plan would be recognised and given effect to in Luxembourg and Germany. Certainty as to the position under overseas laws was not needed.

Recognition in Luxembourg

Experts agreed that a Luxembourg court would recognise the plan if:

- The Luxembourg court did not have exclusive jurisdiction.
- There was some actual connection between the dispute and England.
- The initiation of the English proceedings was not aimed at evading Luxembourg law or a potential Luxembourg judgment.
- The order sanctioning the plan complies with Luxembourg public policy.
- There is no decision of the Luxembourg courts which is irreconcilable with an English order sanctioning the plan.

The High Court found that there was at least a reasonable prospect that these conditions would be satisfied.

Recognition in Germany

Recognition could be achieved under section 343 of the German Insolvency Code (*Insolvenzordnung*).

The plan would be recognised only if COMI was in England at the time of the order sanctioning the plan.

COMI shifting works

The Court confirmed that the COMI shift in this case was effective.

There was extensive argument on forum shopping but the Court found that this was not a case of "bad" forum shopping, there were sound legal and commercial reasons for it.

Relevant alternative and valuation

Relevant alternative = whatever the court considers would be most likely to occur in relation to the plan company if the compromise or arrangement were not sanctioned

Relevant alternative found to be liquidation

The Court accepted the plan company's argument that liquidation of the plan company and borrowers was the relevant alternative.

Alternative Luxembourg based restructuring not the relevant alternative as unlikely to be implemented

- Dissenting creditor, Bank J. Safra Sarasin (**Safra**), argued that an alternative plan which it said could be proposed under the new Luxembourg restructuring law was the relevant alternative.
- The Court found that the Safra proposal would not be likely to be implemented and therefore would not be the most likely alternative to the plan because:
  - It would likely require all of the senior creditors to vote in favour, so a single senior creditor could veto it.
  - Senior creditors representing 97.3% in value had indicated their opposition to the Safra proposal, so it was likely at least one would veto. Even if a lesser majority was needed that was also unlikely to be achieved.
  - The Safra proposal did not provide sufficient funding to complete the development.
  - There was uncertainty as to whether the Safra proposal would produce the maximum funding it claimed.
  - The proposal did not explain in sufficient detail how the senior creditors would be repaid on the extended maturity date.
  - Senior creditors would need a high degree of assurance that the proposal could be implemented successfully in a reasonably short period of time to support it and they didn't have that.
  - Senior creditors may conclude that pursuing the proposal would potentially only delay a liquidation, which would further reduce likely recoveries.
- The Court concluded that the senior creditors would likely not support the proposal and would instead make the best of a low but at least certain recovery in a liquidation.

Dissenting creditors wishing to challenge valuation must provide their own evidence

- Safra challenged the plan company's valuation of the company's assets and therefore likely recoveries in a liquidation but did not put forward any of its own valuation evidence.
- The Court therefore accepted the plan company's evidence.
- Dissenting creditors looking to challenge need to put forward their own valuation evidence to support their claim that the plan company is wrong.

Give and take: A compromise or arrangement is required

The law prior to this case

- Statute requires that a plan must propose a compromise or arrangement between the company and its creditors or members (or any class of them) (Condition B in section 901A of the Companies Act 2006).
- The Court of Appeal in *Adler*[5] expressed a provisional view that a court does not have jurisdiction to sanction a plan which provides for a confiscation or expropriation of rights for no compensation as that is not a compromise or arrangement.
- Prior to the Court of Appeal's decision, and representing the law as it stood when the plan was launched, the High Court in *Prezzo*[6] had said that consideration did not need to be provided to out of the money creditors because they would be "no worse off" even if they were offered nothing under the plan.
- The Court of Appeal, and now the Judge in this case, did not agree with *Prezzo* and it is now clear that a "compromise or arrangement" requires some element of give and take with all classes of creditors.

The problem and the modification

- The plan as proposed initially provided for the subordinated debt to be cancelled with no consideration provided in return.
- Following the provisional view expressed in *Adler* the plan company proposed a modification to the plan to provide for a EUR200,000 fund to be shared by the subordinated creditors.
- The Court found that it did not have jurisdiction to sanction the plan as the plan which was proposed did not represent a compromise or arrangement with the subordinated creditors.
- The plan **must propose a compromise or arrangement with every class of creditors** to whom it is directed, it is not enough that there is a compromise or arrangement with only some classes.
- As there was no jurisdiction to sanction the plan there was also no jurisdiction to sanction the modified plan.
- The Court accepted that it has the ability to sanction a plan which is modified after it has been voted on but before it is sanctioned, but only where there would have been jurisdiction to sanction the original plan.

The solution

- The plan company asked for a further plan meeting to be convened for the senior creditors to vote on the amended plan and for an order under section 901C(4) of the Companies Act 2006 that the subordinated creditors had no genuine economic interest and therefore should not be convened to vote.
- The Court granted both of those orders.
- A further meeting of the senior creditors was held on short notice (3 business days) at which the senior creditors voted in favour of the amended plan.
- A further sanction hearing was held 4 business days later and the amended plan was sanctioned without the need for a cross class cram down.
- This novel first use of the courts' case management powers is likely to be a feature of future plan cases.
- The flexibility demonstrates that courts will seek to provide an efficient path to complete a restructuring even at the end of a highly contested process. In the context of this case, it avoided what would have been a very value destructive further delay.

[5] Re AGPS BondCo PLC [2024] EWCA Civ 24

[6] Re Prezzo Investco Limited [2023] EWHC 1679 (Ch)

Applying the sanction principles

While the Court did not sanction the plan at the first sanction hearing, the Judge went through application of the sanction principles to the plan as if the modification had been made. The Judge relied on the reasons he gave at that first hearing when sanctioning the plan at the second sanction hearing.

SANCTION PRINCIPLES	FIRST SANCTION HEARING	SECOND SANCTION HEARING
Have the statutory provisions been complied with, including: • Condition A: that the company has or will encounter financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern • Condition B: that there is a compromise or arrangement to deal with those difficulties • Classes correctly constituted and requisite majorities obtained • Explanatory statement adequate	Condition A satisfied. Condition B not satisfied on the original plan as there was no compromise or arrangement with subordinated creditors. But would be on the amended plan. Requisite majority of senior creditors obtained. Tier 2 and Junior creditors both dissenting classes. No criticisms of explanatory statement made.	Plan now amended so there is value provided to subordinated creditors. Conditions A and B both satisfied. Requisite majority of senior creditors obtained; subordinated creditors not convened to vote. Same explanatory statement relied upon. No criticisms of it made.
Where there is a cross class cram down, have the conditions in s901G been satisfied: • Condition A: no worse off test • Condition B: assenting class with a genuine economic interest has voted in favour	Condition A satisfied. Relevant alternative is a liquidation under which the subordinated creditors would receive nothing. Under the amended plan they will receive EUR200,000 between them, which is better than in the relevant alternative. Condition B satisfied; the senior creditors voted in favour.	Not applicable as cross class cram down not needed.

Assenting classes fairly represented and majority not coercing the minority to promote interests adverse to the class	Satisfied. 97.3% by value voted in favour. No suggestion that they were doing anything other than seeking the best outcome for themselves as senior creditors.	97.3% by value voted in favour. Judge relied on reasons given in first hearing.
Focusing on assenting classes, is the plan a fair plan which members of those assenting classes could reasonably approve?	Satisfied that an intelligent and honest person acting in respect of their interests might reasonably approve the plan at the meeting of senior creditors.	Satisfied, relied on conclusions reached at first sanction hearing.
Where there is a cross class cram down, has there been a fair distribution of the benefits of the restructuring?	Subordinated creditors were out of the money and had no entitlement to share in the benefits of the plan. The sharing of the restructuring surplus as proposed in the plan would not prevent it being sanctioned. Subordinated creditors would obtain nothing in the relevant alternative and therefore have no genuine economic interest for the purposes of section 901C(4) of the Companies Act 2006. An order could be made under that section, and in fact was for the reconvened plan meetings.	Not applicable as cross class cram down not needed.
Sufficient connection/recognition in other jurisdictions	There is jurisdiction to sanction the plan as long as the plan company is a company liable to be wound up under the Insolvency Act 1986. Connection with England is not required for the Court to have jurisdiction to sanction the plan. It is a factor to consider when deciding whether to exercise discretion. Enquiry is closely related to whether the plan will, if sanctioned, have a substantial effect, which it was likely to as there is a reasonable prospect of recognition in Luxembourg and Germany, and it significantly alters senior creditor rights and they have submitted to the jurisdiction.	Satisfied, relied on conclusions reached at first sanction hearing.
Any blot on the plan?	No blots on the plan.	Satisfied, relied on conclusions reached at first sanction hearing.