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English Court Approves First “Unsecured Credit Bid”, in Administration of Sova Capital

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At a Glance

The English Court approved the first “unsecured credit bid”, in the special administration of Sova Capital.¹ The court granted Sova’s administrators permission to enter into the sale of Russian securities (representing the bulk of Sova’s estate) to an unsecured creditor, in consideration for that creditor waiving its claim against Sova.

In categorising the transaction as a “sale” to a creditor rather than a “distribution”, the court found that the *pari passu* principle (which requires equal treatment of unsecured creditors in insolvency) did not apply.

The court’s judgment provides detailed guidance as to the methodology used to value the unsecured credit bid. Notably, the sale consideration was evaluated on the basis of the dividend that the buyer would have received in the administration had the transaction not taken place; it was not calculated on the basis of the full value of the buyer’s claim. Although the nominal value of the relevant securities (c.£274 million) was higher than the amount of the buyer’s c.£233 million unsecured claim, various Russia-related factors made the realisable value of securities far lower.

The case was opposed by another unsecured creditor (and competing bidder).

Background

Sova Capital is an FCA-authorised regulated investment broker, which used to trade mostly in the Russian market. Following the Russian invasion of Ukraine and related market turmoil, Sova entered special administration in March 2022. Most of Sova's estate (87%) consisted of Russian securities, which were illiquid or otherwise unrealisable other than for a much-reduced price, given sanctions, Russian counter-sanctions and the need for the Russian government's consent for certain transactions.

Sova's administrators sought directions that they be at liberty to sell a portfolio comprising the bulk of Sova's Russian securities (the **Target Russian Securities**) to Dominanta, one of Sova's largest unsecured creditors (with an admitted claim of c. £233 million), in return for Dominanta waiving its claim against Sova (the **Transaction**). Sova and Dominanta were also related parties: the ultimate beneficial owner of Sova was also the ultimate beneficial majority owner of Dominanta.

The application was opposed by another unsecured creditor of Sova which itself wished to acquire the relevant portfolio of securities (as part of a consortium).

The administrators estimated the nominal value of the Target Russian Securities at c. £274 million to those able to trade in them unimpeded by sanctions regimes, though it was common ground that the realisable value of the assets was far lower, given the effects of sanctions regimes. It was considered completely uncertain when (if at all) Sova might be able to sell the Target Russian Securities unimpeded by sanctions regimes or how the value of the securities might change in the interim.

Administrators are generally required to make their own commercial decisions in conducting the business of the company in administration; however, they may seek the court's directions in certain circumstances.

Methodology for calculation of cash equivalent value of bid

As noted, the consideration for the Transaction consisted of Dominanta waiving its unsecured claim against Sova. The administrators calculated the cash equivalent value to Sova of the Transaction as follows:

- a. Start with the final dividend payable to creditors assuming that the Transaction does not take place.
- b. Then assume that the Transaction happens (and that the full amount of Dominanta's admitted claim is waived) and determine the final dividend for the

other creditors (based on other assets in the estate).

- c. Then calculate the amount that would have to be contributed to the estate to pay the dividend that would be payable under b. above, but on the assumption that Dominanta's admitted claim remains. This was the cash equivalent value (**CEV**) of the Transaction to Sova.

The CEV can also be understood by (notionally) assuming that Dominanta:

- a. receives an initial dividend (from assets otherwise available to the estate); and
- b. successfully bids this dividend for a proportion of the Target Russian Securities, then
- c. receives another dividend (being its *pari passu* share of the amount paid into the estate at b. above); and
- d. bids that dividend for another portion of the Target Russian Securities. It iteratively receives and bids subsequent dividends until it has acquired all the Target Russian Securities.

On this basis, the total amount of the dividends that would have been received and paid back to Sova in order to acquire Target Russian Securities is the same as the CEV. The court noted that this model – which the administrators termed the “Dividend Bid Model” – is best seen as a way of conceptualising how the amounts contributed by a bidder swell the estate; it is not a description of the way things would actually happen under the Transaction.

These calculations depended on the final dividend rate payable to Sova's creditors, which could not be known until the conclusion of the administration. However, the administrators had calculated projected final dividends on the basis of various assumptions.

Judgment

The court granted the administrators permission to enter the Transaction, as noted, notwithstanding opposition from another unsecured creditor (/competing bidder).

The court found that the administrators had not “surrendered their discretion” to the court, as the opposing party had contended. Rather, it was clear that the administrators had decided to exercise their discretion in a specific way, by entering the Transaction – but had structured it as dependent on obtaining approval.

The court held this was a proper case for the administrators to seek the court's approval, given (among other factors):

- a. the very unusual circumstances, including the sharp asymmetry of value of the relevant property from different parties' perspectives;
- b. the legal mechanism of the Transaction, i.e., the novel unsecured credit bid (although the court did not use that term); and
- c. the potential applications of sanctions laws.

The court held that:

1. administrators' power to dispose of the company's property is broad enough to cover a transaction in which a creditor waives its claim against the company;
2. in exercising that power, administrators are required to act reasonably to obtain the best price in the circumstances;
3. the Transaction was properly characterised as a sale/disposal rather than a distribution: Dominanta would receive the Target Russian Securities as a buyer and would cease to be a creditor. It would not be receiving anything in its capacity as a creditor and would not receive a distribution;
4. accordingly, the "*pari passu* principle" (that the distribution among unsecured creditors of assets available in an insolvent estate should be equal) did not apply and did not undermine the administrators' powers to sell the Target Russian Securities to Dominanta. The *pari passu* principle is concerned with equality of distribution and does not apply to sales of assets. There was no basis for saying that the Transaction was a disguised distribution to Dominanta;
5. the asymmetrical value of the Target Russian Securities for non-Russian vs Russian owners arose from various sanctions-related restrictions; it was unrealistic to suggest that Sova would be able to realise anything like the nominal value of the securities. Accordingly, if Dominanta – as a "special purchaser" – should do better economically than the other creditors, that was not because of the distribution of the assets of the estate, but was rather a collateral consequence of the legal restrictions which had "strangled" Sova's ability to obtain full value for its assets (in the sense of the value that a Russian could obtain); and
6. the fact that Dominanta and Sova were connected parties did not impair the administrators' power to enter into the Transaction, though it could be relevant to the exercise of that power, e.g., in requiring them to take steps to ensure that a proper price and terms had been negotiated.

The court found that the administrators' decision to enter the Transaction was an honest and rational one and fell within the scope of their powers. There was no realistic risk that the Transaction would infringe applicable sanctions regimes. Accordingly, the court granted the administrators permission to enter the Transaction.

1. *Re Sova Capital Ltd (in special administration)*; judgment [here](#). ↵

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Suggested Reading

- 26 April 2023 Speaking Engagement PLI's Bankruptcy & Reorganizations 2023: Current Developments
- 24 February 2023 Sponsored Event The 19th Annual Wharton Restructuring and Distressed Investing Conference
- 17 February 2023 Award Chambers Global: The World's Leading Business Lawyers 2023

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