KIRKLAND & ELLIS

Adler: English Court of Appeal Overturns Restructuring Plan

Successful challenge from longer-dated noteholders on breach of "*pari passu*" principle, in first-ever appeal of a UK restructuring plan

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At a Glance

The English Court of Appeal today handed down its 65-page judgment unanimously overturning approval of Adler's restructuring plan, following a successful challenge from an ad hoc committee of holders of 2029 Notes (the **2029 AHG**). Adler's plan is the first to be appealed since restructuring plans were introduced c.3.5 years ago.

The 2029 AHG successfully contended that creditors' treatment under the plan **unjustifiably diverged from the "*pari passu*" treatment** which the unsecured notes amended under the plan would receive in the liquidation alternative to the plan (in which all plan creditors would have been entitled to a *pro rata* share of recoveries).

This seminal judgment by Snowden LJ clarifies existing case law on restructuring plans and sets a framework for the exercise of the court's discretion in binding dissenting classes to restructuring plans.

Background

Cross-class cram-down: For the Court to have jurisdiction to approve a restructuring plan which binds a dissenting class (here, the 2029 Notes), it must be satisfied that (A) no member of the dissenting class is "any worse off" under the plan than they would be in the event of the relevant alternative and (B) at least one class which would be "in the money" in the relevant alternative has approved the plan (by ≥75% by value, of those voting). The Court then has discretion as to whether to sanction the plan.

Test on appeal: The Court of Appeal will not interfere with a first-instance decision to exercise discretion to sanction a plan unless satisfied that the judge (A) applied incorrect legal principles, (B) took into account irrelevant factors or omitted to take into account relevant factors, or (C) came to a conclusion on the facts that no reasonable judge could reach.

- The Court of Appeal held as follows.
- **Pari passu principle:** The preservation of existing maturity dates under Adler's plan represented a clear departure from the pari passu principle, without proper justification. Whilst the "elevation" of 2024 Notes in exchange for a one-year maturity extension also departed from the pari passu principle, this could be justified.
- **Framework for exercise of Courts' discretion:** The Court of Appeal's judgment offers a framework of factors to guide the exercise of Courts' discretion in future restructuring plans involving cross-class cram down (**CCCD**), once the statutory conditions (below left) are satisfied. In particular, departure from the pari passu principle is permissible **provided** that there is a good reason for that departure – such as where creditors provide some additional benefit to assist the achievement of the purposes of the restructuring in the interests of creditors as a whole.
    - The parameters for such differential treatment remain to be developed in future cases. For example, whether elevation is justified may depend on whether e.g. the ability to provide new money was available on an equal and non-coercive basis to all creditors; the new money was not more expensive than the company could have obtained in the wider market; and the extent of the elevation was not disproportionate to the extra benefits provided by the new money.
- **"Fairer plan":** In considering whether the allocation of post-restructuring assets is fair, the Court is required to consider whether a different allocation would have been possible.
- **No "zero'ing":** The Court does not have jurisdiction to approve a compulsory cancellation or transfer of shares in a debtor company for zero consideration. (This was expressed as a provisional view only.)
- **Timetable:** Courts' willingness to decide cases quickly must not be taken for granted or abused; sufficient time for the proper conduct of a contested process must be factored into the timetable. Parties/advisors must also co-operate to narrow the issues for decision, "so that sanction hearings are confined to manageable proportions".
- **What now?** The Court of Appeal's judgment sets aside the first-instance sanction order without making a substantive order as to the effect of the decision - although the judgment states that, at least so far as English law is concerned, the alterations to Notes under the plan are ineffective. However, following the judgment, Adler Group announced it considers the amendments remain in full force under German law. What happens next is uncertain. It may need to be considered by reference to the specific restructuring documents and may ultimately involve litigation in multiple jurisdictions as to how to "unscramble the egg". **We are happy to discuss this further with interested clients.** The Court of Appeal judgment makes clear that, if similar circumstances arise in the future, parties should raise with the judge the issues that might arise if the plan were to be made effective before an appeal.
- **See Key Takeaways on next page.**
- Kirkland & Ellis advised the ad hoc committee of Adler Real Estate noteholders, who were not subject to the restructuring plan.

"By adhering to a sequential payment of the different series of Notes, the Plan departed in a material respect and without justification, from the scheme of pari passu distribution of the assets of the Group to Noteholders that would have applied in the Relevant Alternative."

"It is likely to be justifiable that creditors who provide some additional benefit or accommodation to assist the achievement of the purposes of the restructuring in the interests of creditors as a whole, should be entitled to receive some priority or a proportionately enhanced share of the benefits."

Extracts from Court of Appeal judgment, 23 January 2024

Key Takeaways

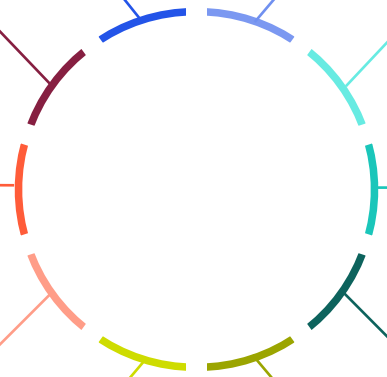
New test required for CCCD: The traditional "honest and intelligent person" test (on schemes of arrangement) does not apply to plans involving CCCD, where classes have differing views as to what a fair distribution should look like

Pari passu: Where a "wind down" plan is proposed as an alternative to formal insolvency in which creditors' claims would rank equally, the Court will normally approve a plan which replicates pari passu distribution of the post-restructuring value

Departure from the pari passu principle is permissible **provided** there is a **good justification** or proper basis for that departure – e.g. for creditors who provide some additional benefit to assist the restructuring, or exclusion of claims of trade creditors/employees

"Fairer plan": The Court is necessarily required to consider whether a different allocation of value would have been possible, for cases involving CCCD

Preservation of different maturity dates on Adler's plan was a "clear departure" from the pari passu principle, without proper justification; "elevation" of 2024s also breached pari passu principle but was justifiable



Retention of equity by existing shareholders (without new value) was not unfair. Provisional view that **rights cannot be "zero'd"** under a restructuring plan without consideration

Overall support for plan is not relevant when deciding whether it is fair to impose the plan upon a dissenting class

Disclosure: plan company must make available the material underlying valuations; if agreement is not forthcoming, the Court should robustly exercise its power to order specific disclosure of key information and its other case management powers

Timing: judge went "above and beyond the call of duty"; Courts' willingness to decide cases quickly "must not be taken for granted or abused". Parties/advisers must co-operate to narrow issues for decision; sufficient time must be factored into timetable

Co-issuer technique: Question mark raised over "co-issuer" technique, though not ruled out; question did not arise for determination on the appeal

Remedy: sanction order set aside; as a matter of English law, alterations to Notes under the plan are ineffective; however, Adler Group has announced it considers the amendments remain in full force under German law

Background –Adler's Restructuring Plan

- *Restructuring plan:* sanctioned by the Court on 21 April 2023
- *Business:* development of, and investment in, multi-family residential real estate in Germany
- *Debt:* six series of *pari passu* senior unsecured notes (the **Notes**), in an aggregate amount of €3.2 billion, with maturities ranging from 2024 to 2029; all governed by German law; originally issued by Adler Group S.A. See indicative structure in Annex
- *Plan company:* AGPS Bondco Plc, incorporated in England, which was substituted as the issuer of the Notes pursuant to a contractual substitution procedure under the terms and conditions of the Notes (the **Issuer Substitution**), for the purposes of proposing the plan
  - The 2029 AHG disputed the validity of the Issuer Substitution as a matter of German law. A member of the 2029 AHG has issued proceedings in Germany for declaratory relief that the Issuer Substitution is invalid; those proceedings have been stayed pending the outcome of the English appeal
- *Purpose of the plan:* to amend the Notes (including an extension of the maturity of 2024 Notes) and permit new money funding. The plan was characterised as a "wind-down plan", given it provides for the realisation of the Group's assets and the distribution of the proceeds to plan creditors over time
- *Financial difficulties:* the Group had been significantly and adversely affected by the German domestic and global economic downturn; it faced a critical liquidity shortage as a result of an impending debt maturity on 27 April 2023[1], with impending cross-defaults
- *Relevant alternative:* formal insolvency of key Group entities by end April 2023, in which all the Notes would be accelerated and rank *pari passu* for payment

	CREDITOR CLASSES[2]	TREATMENT UNDER PLAN	EST. DIVIDEND IN RELEVANT ALTERNATIVE	APPROVED?
		All plan creditors were offered the option to participate in €937.5m new money (with pro rata share of 22.5% post-issuance equity)		
1	**€400m 2024 Notes**	Maturity extended by c.12 months; granted priority over other series of Notes (but behind new money); no haircut	63% for all classes (*pari passu*)	✓
2	**€400m 2025 Notes**	**No maturity extension or haircut: repaid at par in accordance with original maturity dates (or earlier)**	However, the 2029 AHG's advisors produced evidence adopting a lower figure of 56% recovery in the relevant alternative	✓
3	**€700m January 2026 Notes**	*All Notes amended: (i) to permit the refinancing of existing debt on a secured basis; (ii) to permit the injection of the new money financing; (iii) to vary the coupon on the Notes to provide for an interest payment holiday and uplift; and (iv) to vary the financial reporting covenants*		✓
4	**€400m November 2026 Notes**			✓
5	**€500m 2027 Notes**			✓
6	**€800m 2029 Notes**	*Group plans to dispose of all development assets by 4Q25 and all yielding assets by 4Q26; all Group entities to be liquidated in 2027*	*62% approved, but requisite 75% consent threshold not met* →	X

2029 AHG asserted, at first instance, that their recovery could be as low as 10.6% under the plan, given deteriorating real estate markets

Across all 6 classes, the plan was supported by c.84% of those voting

1. The relevant debt – €500m senior unsecured notes issued by Adler Real Estate AG (i.e. structurally senior to the Notes) – was unamended by the plan and was repaid in full out of new money (€937.5m secured, super-senior term loans maturing 30 June 2025).
2. The plan excluded certain categories of debt, including: structurally senior unsecured notes issued by Adler Real Estate AG, in an aggregate amount of €1.1bn; €165m convertible notes; unsecured promissory notes in an aggregate amount of €24.5m; and €261m of secured debt owed by Consus Real Estate AG and its subsidiaries.

Court of Appeal's Verdict

Unjustifiable departure from *pari passu* treatment in the relevant alternative

- The 2029 AHG had argued that:
  - the plan involved differential treatment of the Notes, principally (a) the preservation of staggered maturity dates for the Notes (instead of aligning maturity dates) and (b) the grant of prior-ranking security for the 2024 Notes; they also raised additional issues regarding the terms of new money and the allocation of equity; and
  - there was no proper justification for this differential treatment, especially since the Group was not being rescued as a going concern under the plan.

- The Court of Appeal ruled as follows.
  - The first-instance judge was wrong to conclude that Adler's plan did not depart from the principle of pari passu distribution of assets that would have applied in the relevant alternative: "The Plan represented a clear departure from that principle", by **preserving staggered maturity dates**. "Put shortly, sequential payments to creditors from a potentially inadequate common fund of money are not the same thing as a rateable distribution of that fund."
  - In a "wind down" plan proposed as an alternative to a formal insolvency in which creditors' claims would rank equally, the Court will normally approve a plan which replicates that *pari passu* distribution of the post-restructuring value.
  - A **departure from *pari passu* distribution is permissible** provided there is a "**good reason** or proper basis for that departure". The Court of Appeal did not attempt to prescribe a list of criteria that might qualify as a "good reason" – but gave examples of creditors who provide some **additional benefit** or accommodation to assist the achievement of the restructuring, such as those providing **new money, trade creditors or employees**.
  - Whilst the **priority given to the 2024 Notes** also involved a departure from the pari passu principle, this "elevation" could be justified by the continuation of credit (i.e. the one-year maturity extension of the 2024 Notes under the plan).
  - **Retention of equity** by existing shareholders did not infringe the principle of pari passu distribution, which does not require shareholders to forfeit their shares. Additionally, the Court of Appeal provisionally held that there is **no jurisdiction under Part 26A to sanction a compulsory cancellation or transfer of the shares in a debtor company for no consideration.**

Alternative plans are relevant to the assessment of the fairness of restructuring plans

- In the context of a restructuring plan in which the court is asked to exercise CCCD, the court is necessarily required to consider what alternative arrangement might have been proposed, as a necessary part of assessing whether the allocation of rights under the plan was fair.

Conventional "rationality test" does not apply to restructuring plans involving CCCD

- The "honest and intelligent person" test (applicable to the exercise of discretion for schemes of arrangement) is inappropriate for restructuring plans where CCCD is sought, given the requisite approval level will (by definition) not have been reached in each class.
- The "rationality" test does not work where different classes have differing views as to what a fair distribution should look like. There can be no assumption that the assenting classes have any commonality of commercial interests with the dissenting class(es).

Court of Appeal's Verdict (cont.)

Reliance upon overall level of support

- The Court of Appeal held that the overall level of support for the plan should not be taken into account by the Court in deciding whether it is fair or appropriate to bind a dissenting class – owing to the dissimilarity of rights between the assenting and dissenting classes.
- However, the Court may place some reliance on the views of (e.g.) a simple majority in the dissenting class that voted in favour of the plan (short of the statutory 75% threshold), as in Adler. If the Court is to place any weight on this factor, it will also require an examination of the commercial reasons why the plan might be thought to be in the interests of the dissenting class.

"Vertical" and "horizontal" comparisons

- *Background:*
  - The vertical comparison involves a comparison of the position of the particular class of creditors in question under the restructuring proposal with the position of that same class in the relevant alternative. The horizontal comparison compares the position of the class in question with the position of other creditors (or shareholders) if the restructuring goes ahead.
  - As noted, it is a statutory condition to the Court's jurisdiction to bind a dissenting class (here, the 2029 Notes) that no member of the dissenting class would be "any worse off" under the plan than they would be in the event of the relevant alternative.
- **Held:**
  - Satisfaction of the "no worse off" test does not give rise to a presumption in favour of sanction.
  - A key issue on a potential CCCD 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.
  - Exercise of 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 Court of Appeal declined to rule on certain additional grounds of appeal, as these were unnecessary to determine given the Court's conclusions on the main grounds of appeal.

The additional grounds related to satisfaction of the "no worse off" test (e.g. that the judge had erred in not concluding that the financial analysis put forward by the company was inadequate) and whether the judge had erred in not concluding there was a "blot" on the plan (as certain Notes had been accelerated prior to the sanction hearing).

Additionally, the Court of Appeal accepted that certain **inadequacies in the explanatory statement** undermined any confidence the Court could have in the support for the plan among the "pure" 2029 Noteholders (i.e. those without cross-holdings in other series of Notes). This was not, however, a separate ground of appeal.

Revised Framework for Exercise of Court's Discretion on Restructuring Plans

Where there is no cross-class cram down

Where every class approves the restructuring plan, established principles on schemes of arrangement apply, i.e.:

1. whether the provisions of the statute have been complied with (including questions of class composition, statutory majorities, and adequacy of the explanatory statement);
2. whether the class was fairly represented by the meeting and whether the majority were coercing the minority in order to promote interests adverse to the class whom they purported to represent;
3. whether the plan is a fair plan which a stakeholder could reasonably approve (although the Court is not concerned to decide whether the plan is the only fair plan or even the "best" plan); and
4. whether there is any "blot" or defect that would e.g. make it unlawful or inoperable.

Where there is cross-class cram down

Where not every class approves the plan and the Court is asked to exercise its power to bind a dissenting class, the conventional approach (*left*) requires modification, in light of the Court of Appeal's judgment.

1. *continues to apply, as left*
2. as regards each **assenting class**, the Court should consider whether the class was fairly represented by the meeting and whether the majority were coercing the minority – especially for "in the money" classes whose vote is relied upon to invoke CCCD
3. **significant modification required**:
   - for an assenting class: broadly, conventional principles apply when considering whether to impose a plan on the dissenting minority within an assenting class;
   - however, for a dissenting class:
     - the Court **cannot simply apply the same rationality test**, either (a) as regards the voting within the dissenting class or (b) as regards the overall voting across the different classes; it is not appropriate for the Court to draw comfort from the support of an assenting class when deciding whether to impose the plan on a dissenting class. The Court must engage with the underlying commercial issues;
     - satisfaction of the **"no worse off" test** (the "vertical comparison") is a jurisdictional threshold; it does not create a presumption in favour of CCCD;
     - it is appropriate to conduct some form of "**horizontal comparison**" and 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** - e.g. creditors providing a benefit to assist the restructuring in the interests of creditors as a whole, "should be entitled to receive some priority or a proportionately enhanced share of the benefits";
       - it will take a "compelling reason" to persuade the court to sanction a plan which allocates the benefits of a restructuring differentially between assenting and dissenting classes without justification;
     - an obvious reference point for this exercise must be the **position of the creditors in the relevant alternative**;
     - the Court must 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 different creditor groups; and
     - the Court is necessarily required to consider whether a different allocation of value would have been possible
4. *continues to apply, as left*

Annex: Indicative Structure