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# Alert | Restructuring & Bankruptcy

30 March 2022

## Smile Telecoms Restructuring Plan Sanctioned by Lord Justice Snowden – A Number of Restructuring Plan 'Firsts' Established

*Despite a valuation fight, the Senior Lenders primed by Super Senior Debt in RP1 have had their debt written off in full in RP2 without even being given the opportunity to vote on the latter restructuring plan.*

*The case emphasizes that it is not enough for junior creditors to send letters to the court objecting to the RP and then expect the court to argue their case for them. In the words of Lord Justice Snowden, "they must stop shouting from the spectators' seats and step up to the plate".*

*It also provided key guidance around requirements in relation to evidence provided to the court.*

On 30 March 2022 the English High Court (the Court) sanctioned a restructuring plan (an RP) proposed by Smile Telecoms Holdings Limited (Smile) pursuant to Part 26A of the Companies Act 2006 (the Act) (the Smile RP or RP2).

**Greenberg Traurig, LLP advised the Super Senior Lender, 966 CO. S.à r.l. (966) which was the only member of the "in the money" voting class.**

For a general overview of the corporate rescue tools available in the UK, please click here.

A summary of the key issues is set out below:

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## 'Priming risk' for senior lenders

The Smile RP demonstrates the risk assumed by secured creditors who permit super senior debt to be introduced into a debtor's capital structure which 'primes' the secured creditors' claim. The super senior creditors will be a separate class in any subsequent RP and will be able to use cross-class cramdown against the secured creditors and the other classes in the debt stack where out of the money.

In the case of the Smile restructuring, Smile needed emergency funding prior to its first restructuring plan implemented in 2021 (RP1) to enable it to run a controlled sales process of the Smile group assets (the M&A Process). The secured lenders to the Smile Group (the Senior Lenders) were not willing to lend that money and so a new "super senior loan" was made under RP1 by another stakeholder which primed the existing Senior Lenders.

Secured creditors will typically have an opportunity to participate in super senior rescue funding. If they choose not to do so, they run the risk that a future RP could be used by the debtor to upsize the super senior debt to levels where the existing secured creditors will be at risk if there were a shortfall in recoveries.

In the space of less than a year following RP1, independent valuations and a market testing exercise determined that the Senior Lenders were in fact fully out of the money. Accordingly, their debt could be written down to zero in a further restructuring plan (RP2) by a single class vote by the super senior creditor, again using the cross-class cramdown. On top of that, the Senior Lenders were excluded from even voting on RP2 (see 'Single creditor vote' below).

## Single creditor vote

This is the first time an application under section 901C(4) of the Act has been used to exclude out of the money classes of stakeholders from voting on an RP on the ground that they had 'no genuine economic interest' in Smile. By avoiding the need for additional RP meetings for out of the money creditors to vote at, Smile avoided the time and cost of holding the meetings, and the RP process was more streamlined in that regard.

A 901C(4) application has been part of England's restructuring tool kit since the enactment of the Corporate Insolvency and Governance Act 2020 in partial response to the economic turmoil caused by the COVID-19 pandemic. However, until the Smile RP, out of the money dissenting stakeholders have only been 'crammed down' pursuant to the cross-class cram down procedure in section 901G of the Act, which involves all stakeholder classes being given a vote in the RP.

A 901C(4) application removes the need to give out of the money stakeholders a vote provided that valuation evidence demonstrates they have no genuine economic interest in the relevant company. The Court was therefore focused in both the convening hearing and the sanction hearing on the nature of the valuation evidence and the opportunities that affected stakeholders had to examine it (see below).

This development brings England closer to the position of Chapter 11 in the United States, where the Chapter 11 debtor is not required to solicit votes of out of the money creditors because such creditors are statutorily deemed not to have accepted the Chapter 11 plan.

Out of the money creditors in a Chapter 11 still have standing to object to confirmation of the Chapter 11 plan and challenge the valuation evidence on which it is based, which in effect is what happened with RP2.

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## Time to 'Step Up to the Plate'

The Smile decision has significant ramifications for stakeholders lower down the capital structure who may previously have been considered to have 'nuisance' value in financial restructuring transactions. The Smile RP not only demonstrates the ease with which they can be crammed down, it also establishes that if the junior creditors wish to have their objections taken seriously, they must appear in court with expert witnesses who are prepared to be cross-examined.

*Background*

Prior to the sanction hearing, a creditor (the Objecting Creditor) commissioned a report from an alternative valuer (the Alternative Report) which alleged that the valuation of the Smile group was higher than the valuation demonstrated by Smile's own evidence. However, the valuation contained in the Alternative Report was based on a benchmarking exercise against other sale processes of telecommunications spectrum assets which were not, in Smile's view, true comparators for a new sales process that would apply to the Smile assets.

*Analysis*

The Alternative Report was flawed as it did not address the fact that there had been a proper market testing via the M&A Process which did not achieve a single bid from a third party purchaser anywhere near the range of hypothetical values that the Alternative Report attributed to the Smile assets.

This position is consistent with one of the leading English decisions on valuations in schemes of arrangement under Part 26 of the Companies Act 2006 (which is also very relevant to RPs), being the *IMO Car Wash* case[1]. The *IMO Car Wash* case demonstrated, amongst other matters, that the Court will consider the price that a purchaser will actually pay for a business or asset at the relevant time, rather than simply considering a range of possible theoretical valuations.

The Court at the sanction hearing for the Smile RP held that if a creditor wishes to challenge a company's valuation evidence, "*they must stop shouting from the spectators' seats and step up to the plate*". In particular, the creditor should file expert evidence of its own and make the expert available for cross-examination. The creditor should also instruct counsel to appear at the relevant court hearing. Opposing creditors cannot expect the company proposing the RP or the Court to advance the opposing creditors' challenge for them. Therefore, this is a reminder that in order to successfully challenge an RP, opposing creditors should be prepared to fully engage in the litigation process, incur the necessary legal and expert witness costs (and any adverse costs) and ensure that their counsel and expert witness are available, and their expert witness prepared for a thorough cross-examination, at the relevant hearing. That will of course mean objecting stakeholders will have to incur expense up front – expense which may be material and, unlike the position often applying in Chapter 11 cases, unrecoverable.

This position is consistent with the Court's views in the *IMO Car Wash* case, which showed that it is not for the directors to argue the case for out of the money creditors in restructuring negotiations with senior creditors – those creditors need to conduct their own negotiations. The Smile RP is a good reminder that it is the responsibility of out of the money creditors who bring challenges to advance their own arguments and not rely on the company or the Court to do so (unless there is an obvious issue which needs to be drawn to the Court's attention in relation to a proposing company's duty of full disclosure).

[1] *In the matter of Bluebrook Ltd and others* [2009] EWHC 2114 (Ch))

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## Expert Evidence

The Objecting Creditor did not put its experts in front of the Court, but for any junior creditor who is minded to challenge schemes or RPs in the future, not only do they need to "*step up to the plate*" they would also do well to remind themselves of the unsuccessful challenge mounted in the *Colt Telecom*[2] case where the Civil Procedure Rules were also considered in the context of a contentious restructuring. The judge in that case emphasised that any expert providing evidence to the Court owes a duty to the Court to ensure that there is a range of opinions in the matters dealt with in the relevant report, the expert must give:

(i) a summary of the range of opinions; and

(ii) the reasons for the expert's own opinion.

Most importantly, if such opinion was not formed independently, the expert should make clear the source of the opinion. In other words, as the judge put it in *Colt*, the expert must not "unconsciously espouse his clients' cause".

This will be a difficult tightrope for experts to walk, a feat which has been made even harder since 1 October 2020 when the Civil Procedure Rules doubled down on the importance of this issue by introducing amendments to the statement of truth for expert reports which now references contempt of court proceedings for opinions that are not true, complete or 'not their own'.

*Standard of evidence generally in respect of RPs*

Lord Justice Snowden in *Smile* made a number of observations regarding the application of the Civil Procedure Rules as they apply to the provision of expert evidence in court proceedings in England, including in respect of schemes and RPs.

This is a salutary reminder both for those presenting the company's evidence before the Court as well as for any opposing creditors who are considering putting evidence before the Court to challenge a scheme or an RP. The RP, with the new key feature of cross-class cramdown, is a powerful tool and it is clear that the court will ensure that it is wielded responsibly by companies, as well as ensuring that those who seek to challenge "step up to the plate" and are prepared to face cross-examination.

*Hurricane*[3] is a stark reminder that any company considering an RP needs to prepare its evidence carefully as to both the "relevant alternative" and the "no worse off" test. And in *Virgin Active*[4] both the valuation evidence put forward by the company and the evidence of the opposing landlord group were rigorously tested by cross-examination. We can expect far more of this in future RPs.

## The importance of valuation evidence

The restructuring market had long expected that valuation evidence would be more prominent and prone to more challenges in the new Restructuring Plan procedure than had been the case with Schemes of Arrangement and the Smile RP did not disappoint in that regard.

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[2] *Re Colt Telecom Group plc* - [2002] All ER (D) 347 (Dec)
[3] *In the matter of Hurricane Energy PLC* [2021] EWHC 1759 (Ch)
[4] *In the matters of Virgin Active Holdings Limited, Virgin Active Limited and Virgin Active Health Clubs Limited* [2021] EWHC 1246 (Ch)

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Valuation was a central issue at both the convening hearing (where it went to the core of whether the Senior Lenders were in fact "out of the money" and therefore not entitled to a class vote) and at the sanction hearing where the Alternative Report was considered. In any RP which seeks to cram down classes of stakeholders, robust and detailed valuation evidence is critical. In the cross-class cram-down procedure in section 901G of the Act, one of the conditions that must be satisfied is that none of the members of the dissenting class would be any worse off than they would in the event of the 'relevant alternative'. In the case of the Smile RP, the relevant alternative was the administration of Smile and the liquidation of the key operating companies in the Smile group. In this relevant alternative, the only class to receive any recovery would be 966 and the other stakeholders would receive zero recoveries.

However, in order to make a 901C(4) application in the Smile RP, it needed to be demonstrated at the convening hearing that no other class of stakeholder had a 'genuine economic interest' in Smile. Given that stakeholders will not only be crammed down by a 901C(4) application but will also be denied the opportunity to vote on an RP, the valuation evidence in such an application is all the more important in terms of (i) robustness and detail and (ii) giving stakeholders sufficient time to test and interrogate the evidence.

In considering the valuation evidence provided, the Court's view at the convening hearing was that "*…the evidence establishes that, using the Grant Thornton analysis, the Senior Lenders and those below the Senior Lenders are well out of the money. This is not a marginal case.*"

It was noted that all stakeholders who had agreed to sign an NDA were provided with a copy of the relevant valuation materials prepared by Smile's advisers, being independent investment banks experienced in the African telecoms market. The M&A Process was also monitored by Smile's financial adviser, Grant Thornton, as well as the Senior Lenders' financial adviser, PwC.

It was explained to the Court that the Senior Lenders had been given ample time to interrogate the valuation evidence obtained by Smile and the M&A Process carried out to date, including Q&A sessions with the M&A advisers leading the process. The Senior Lenders were also invited during the restructuring negotiations to participate in the new money facility as well as to provide any alternative bidders if they believed that the M&A Process had not been thorough enough.

Grant Thornton prepared an insolvency comparator report and an estimated outcome statement which demonstrated that all classes of stakeholders other than 966 were completely out of the money. Prior to the convening hearing, the Objecting Creditor challenged the basis on which some of the valuation evidence was provided but Smile responded to these challenges and the Court accepted Smile's responses in the convening hearing.

In the period between the convening hearing and the sanction hearing the Objecting Creditor sent the Alternative Report (relating to valuation) to the company. Lord Justice Snowden characterised it as "*playing a tactical game of keeping their powder dry at the convening stage and only appearing to raise jurisdictional points at the sanction hearing*" which clearly runs contrary to the 2020 Practice Statement which provides that:

> *"While members and/or creditors will still be able to appear and raise objections based on an issue identified … at the sanction hearing, the court will expect them to show good reason why they did not raise the issue at an earlier stage."*

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That is particularly the case where the court has already considered valuation evidence at the convening hearing and based on that evidence has made an order under section 901C(4). It was clear that Lord Justice Snowden had little time for such tactics and observed that:

> *"… not only did [the opposing creditor] not appear at the sanction hearing, but it has given no reason (still less a good reason) why it could not and did not raise the points …. at the convening hearing".*

Lord Justice Snowden came down hard on the opposing creditor's suggestion that this evidence should be left to the company's directors and the court to consider. Whilst it is correct that the company has a duty to bring all relevant matters to the attention of the court, it was established in *IMO Carwash* and affirmed in *Smile* that this did not extend to arguing the opposing creditors' case for them. And as for the suggestion that the matter should be left to the court to decide, Lord Justice Snowden said:

> *"Nor is it realistic, appropriate or fair to judges hearing complex scheme or plan cases, who already carry a heavy burden, to expect the court itself to descend into the fray… [Judges] cannot be expected to conduct a detailed factual investigation into the merits or demerits of the company's valuation evidence in a highly specialist area without any assistance. Still less can they be expected to engage in some sort of vicarious challenge to that evidence on behalf of creditors or members … without help from the expert responsible for it or the benefit of cross-examination.*
>
> *Put simply, if a creditor or member wishes to oppose a scheme or plan based upon a contention that the company's valuation evidence as to the outcome for creditors or members in the relevant alternative is wrong, they must stop shouting from the spectators' seats and step up to the plate".*

### RP Consideration for other Smile stakeholders

The Smile RP was also of interest in the context of the structure of the consideration for the out of the money stakeholders. On one analysis they were entitled to nothing as they were out of the money, but the Company took that view that it would provide certain ex gratia payments as follows:

- for each of the following classes, a $10,000 payment (in aggregate per class) payable on completion of the restructuring: (i) the ordinary shareholders; (ii) the single preference shareholder; (iii) the subordinated lenders; (iv) certain shareholders of Smile which had contingent claims against Smile; and (v) certain other unsecured creditors of Smile each with claims of at least $25,000;
- for the Senior Lenders, a $10 million payment (in aggregate for the whole class) and rights under a new instrument creating contingent value rights (the CVR) in Smile following the receipt of proceeds in the M&A Process. 966 will also receive a share of the CVR; and
- for the facility agent in respect of the Senior Lenders' loans, a $1.2 million payment.

In the sanction hearing, the Court acknowledged that the ex gratia payments were payments in return for modification or extinction of the rights of the RP stakeholders and that they could be taken into account when deciding whether the Smile RP offered some 'compensating advantage' for the removal of those rights.

Indeed, there was an argument that the out of the money creditors could have received no consideration at all and this would not have jeopardised the RP. 966's QC, Tom Smith, submitted that in contrast to a

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scheme, the court can sanction an RP which is binding on a class of dissenting creditors on the basis that none of the dissenting class would be any worse off than they would be in the event of the relevant alternative.

Accordingly, it was argued that if creditors in such a case would receive nothing in the relevant alternative, then it must follow that an RP could be sanctioned which also provided them with nothing in exchange for the release or cancellation of their existing rights. Lord Justice Snowden did not have to decide the point on the facts of the *Smile* case, but clearly there is much to be said for the argument.

### Impact on equity interests of a foreign company

Smile had its centre of main interests in the UK, but it was incorporated in Mauritius. The Court also considered whether it had jurisdiction to sanction an RP which sought to affect and alter shareholders' rights of a foreign company. In the context of solvent schemes of arrangement under Part 26 of the Act, it is not possible to affect the rights of shareholders of a foreign company.

However, in the case of an insolvent RP which seeks to affect the rights of both creditors and shareholders, the judge at the convening hearing was satisfied that the rights of the shareholders could effectively be extinguished by an RP.

Nevertheless, the Objecting Creditor contended that there was a jurisdiction issue because the Smile RP sought to vary the rights of shareholders in a foreign company. This is however misconceived. The court clearly has jurisdiction to sanction an RP in respect of a foreign company where the RP is between the company and its creditors and/or its members. This follows from the definition of "company" in Part 26A which plainly extends to a foreign company. The question is one of "sufficient connection"/"substantial effect" which is an issue of discretion not jurisdiction.

In the present case, the "sufficient connection"/"substantial effect" test was clearly satisfied given that the debt which is the subject of the Smile RP is principally governed by English law, the fact that the Company's COMI is in England and the evidence which shows that the Smile RP will likely be effective as a matter of Mauritian law to vary the relevant rights attaching to the shares.

The absence of a 'parallel scheme' in Mauritius was not a strict legal requirement and Lord Justice Snowden exercised his discretion to sanction the Smile RP on the basis that the procedure envisaged under the RP for altering the constitution and share capital of the company using a power of attorney conferred on the company pursuant to the RP would be acceptable and effective in Mauritius.

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