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Smile Telecoms – Part 26A Restructuring Plan Proposed by a Non-English Company Excludes 'Out of the Money' Creditors and Shareholders from Voting

by Phillip Taylor and Anna Nolan

Smile Telecoms Holdings Limited, which is a Mauritius-incorporated company and the holding company of a group operating an internet and telecommunications business in Africa, has recently proposed its second Part 26A restructuring plan. The written judgment from the convening hearing, which took place on 12 January 2022, has not yet been published. The creditors' meeting was set for 10 February, and the sanction hearing is scheduled for 28 February. This restructuring plan is significant because:

- For the first time, the court has exercised its power under Section 901C(4) of the Companies Act 2006 to exclude 'out of the money' creditors and shareholders from voting on a Part 26A restructuring plan on the basis that they have no genuine economic interest in the plan company.
- It has been proposed by a non-English company.

Background

The Smile Telecoms group suffered financial difficulties, and in March 2021 a first restructuring plan, which facilitated the injection of additional secured debt by the company's super senior lender, 966 CO S.à r.l., was sanctioned by the English courts.

However, the company has faced liquidity constraints and engaged in further discussions with its lenders.

The company has proposed:

- An additional liquidity injection from the super senior lender to prevent an immediate administration of the company.
- A transfer of the shares in the company to the super senior lender.
- The discharge of the company's financial debt ranking after the super senior liabilities in return for certain ex gratia payments.

- The issuance of a contingent value rights instrument by the company to the super senior lender and to the senior lenders, which would allocate any value realised above certain new money and super senior debt repayment thresholds to the lenders.

Exclusion of Classes That Have No Genuine Economic Interest in the Company

The general rule is that every creditor or shareholder of the plan company whose rights are affected by the plan must be permitted to vote on the plan by participating in a meeting convened by the plan company (with the approval of the court granted at the convening hearing).

Section 901C(4) provides for an exemption from the general rule in circumstances where the court 'is satisfied that none of the members of [a] class has a genuine economic interest in the company'.

The court's power under Section 901C(4) to exclude its out-of-the-money creditors and shareholders from voting is very different to the 'no worse off' test for the cross-class cram-down power. The power to exclude a class from voting requires the company to satisfy the court that *none* of the members of the classes to be excluded have a 'genuine economic interest' in the company. In other words, the court has to be satisfied that the excluded out-of-the-money classes do not have any economic interest in the relevant alternative (e.g. liquidation). By contrast, a class may be crammed down whether or not its members have a genuine economic interest, provided that at least one in the money class voted in favour of the plan and the dissenting class is no worse off than it would be in the relevant alternative.

At the Smile Telecoms convening hearing, the court, for the first time, exercised its power under Section 901C(4) to exclude the company's shareholders and out-of-the-money creditors from voting on the plan. The court was satisfied that only one creditor class had a genuine economic interest, and based on the evidence this was not 'a marginal case'.

Sufficient Notice and Opportunity to Formulate a Challenge

If the company intends to rely on Section 901C(4), it will need to ensure that sufficient, comprehensive information is shared with interested parties ahead of the convening hearing because the court will want to ensure that all parties, in particular those who are to be excluded from voting, have had sufficient time and information to examine and challenge the evidence.

In this case, the company provided creditors with draft financial documentation in mid-November 2021 and therefore creditors had almost two months to consider the documentation. As a result, the court was satisfied that creditors had adequate time to formulate a challenge.

Importance of the Valuation Evidence

Exclusion on grounds of 'no economic interest' is a high bar, and the court may refuse to exercise its discretion if:

- The valuation evidence is insufficient.
- There is a tight timetable to complete the restructuring.

- Inadequate notice has been given to excluded creditors so that they don't have sufficient time to consider and prepare for a proper challenge.
- The excluded class has made a challenge early on.

In 'marginal' cases or if there is some uncertainty, the court may require meetings of each relevant class if numerous classes are ultimately subject to a cram down.

In this case:

- The senior lenders, who were out of the money, had accepted the valuation, which was provided to all interested parties that signed an NDA.
- The valuation has been carefully examined by the senior lenders and their advisors.
- Based on the estimated outcome statement (EOS), the senior lenders were clearly out of the money. The senior lenders had sufficient time to consider the contents of the EOS.

Compromise of Rights of Shareholders of a Non-English Company

So far, the company's shareholders have not sought to challenge the plan. The law of incorporation of a company will typically regulate the rights of shareholders (in this case – the law of Mauritius). Some commentators considered that it is not possible for the court to sanction a solvent scheme which affects shareholder rights (e.g. the 2004 *Re Drax Holdings* scheme of arrangement). However, the company has argued that in the case of a plan (rather than a scheme) between an insolvent company and its creditors and shareholders, the court does have jurisdiction to sanction a plan which proposes to alter the rights of shareholders. It remains to be seen if the company will provide evidence at the sanction hearing for recognition of the plan in Mauritius and if the point regarding the amendment of shareholder rights will be further discussed at the sanction hearing.

Key Takeaways

Cross-class cram down versus exclusion of out-of-the-money classes

The companies will need to decide if, depending on the facts of the case, it is better to (1) seek the exclusion of relevant out-of-the-money classes from voting; or (2) ask the court to use its cross-class cram-down power against those classes voting against the plan. So far, the cross-class cram-down power has been used successfully four times (see our advisory on Amicus Finance).

Are the out-of-the-money classes deprived the opportunity to vote?

Yes – the out-of-the-money classes won't vote on the plan. It would be interesting to see how case law on restructuring plans evolves in the future. Especially, it remains to be seen if the courts will be prepared to convene meetings of multiple classes of creditors at the request of the plan company when an interested party argues that the other classes are out of the money.

Although it is a new feature of Part 26A, the court has long been able to approve a scheme of arrangement without requiring approval from out-of-the-money classes. For example, in *Re Tea Corporation CA [1904] 1 Ch. 12*, the contributories were divided into two classes, preference shareholders and ordinary shareholders (who had no economic interest in the assets). The Court of Appeal held that the High Court could sanction the scheme despite the objections of the out-of-the-money ordinary shareholders. However, the application of this rule may depend on the precise nature of the arrangement and of the rights that the company seeks to compromise.

Valuation evidence

It is expected that the court will consider the valuation evidence very carefully. However, the court would be prepared to use its Section 901C(4) power when the valuation evidence shows that certain creditor classes or shareholders are clearly out of the money in the relevant alternative and no competing evidence is provided by creditors or shareholders in the classes that are proposed to be excluded. The valuation evidence is very important, as well as giving anyone who is proposed to be excluded from voting time to consider the evidence. If creditors or shareholders decide to make a challenge, they would need to provide the court with their own valuation evidence.

Disclosure

The plan companies need to keep in mind that if an order under Section 901C(4) is sought, disclosure of financial and other relevant evidence will need to take place at an earlier stage than might otherwise be the case (as described above). However, would that mean that the excluded classes will be inadvertently equipped with more ammunition and more time to bring a successful challenge at the convening hearing?

Court's discretion

When the valuation evidence is more marginal, the affected classes will have a better chance of arguing against their exclusion from voting, and the court will likely be reticent to exercise its discretion to exclude them.

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