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Case No: CR-2020-002762

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND & WALES
INSOLVENCY AND COMPANIES LIST (ChD)

Rolls Building,
Fetter Lane,
London, EC4A 1NL

Date: 18 September 2020

Before :

MR JUSTICE SNOWDEN

- -

Between :

IN THE MATTER OF SUNBIRD BUSINESS SERVICES LIMITED

AND IN THE MATTER OF PART 26 OF THE COMPANIES ACT 2006

- -

Andrew Thornton QC (instructed by **CMS Cameron McKenna Nabarro Olswang LLP**) for the **Company**
Henry Phillips and **Lauren Kreamer** (instructed by **Shoosmiths LLP**) for the **Opposing Creditors**

Hearing dates: 25-26 August 2020

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Approved Judgment

COVID-19: This judgment was handed down remotely by circulation to the parties' representatives by email. It will also be released for publication on BAILII and other websites. The date and time for hand-down is deemed to be 9.30 a.m. on 18 September 2020.

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MR JUSTICE SNOWDEN

MR JUSTICE SNOWDEN :

Introduction

1. This is an application by Sunbird Business Services Limited (the "Company") for the sanction by the court of a scheme of arrangement (the "Scheme") pursuant to Part 26 of the Companies Act 2006 ("Part 26" and the "Act"). The proposed Scheme is between the Company and a group of 32 unsecured creditors who have advanced various forms of loan facilities and credit (other than trade credit) to the Company over time (the "Scheme Creditors").

2. The Scheme was approved at the Scheme meeting by 24 Scheme Creditors representing 80% in number and 87% in value of the Scheme Creditors who voted. It was rejected by 6 Scheme Creditors who held 20% in number and 13% in value of the Scheme Creditors who voted (the "Opposing Creditors"). Two Scheme Creditors did not participate in the Scheme meeting.

3. The Opposing Creditors now object to the Scheme being sanctioned on the basis that the information provided to Scheme Creditors in the Scheme document and explanatory statement required by Part 26 was inadequate and misleading. They also say that an intelligent and honest creditor acting in respect of his interest could not reasonably have approved the Scheme on the basis of such information.

The Company and the Sunbird Group

4. The Company was incorporated on 30 June 2014 in England and Wales. The Company is a holding company and financing vehicle for a number of operating subsidiaries (together the "Group"). The operating subsidiaries provide serviced offices, facilities, management and construction services in Eastern and Southern Africa (namely in Kenya, Tanzania, Mozambique, Uganda, Zambia, and South Africa). The co-founders and Managing Directors of the Company are Mr. Michael Aldridge ("Mr. Aldridge") and Mr. William Sykes. The remaining members of the board are non-executive directors and include its non-executive Chairman, Mr. John McDonough.

5. In the past two years, the Company has moved the Group's business away from being a multi-disciplinary service group towards becoming a provider of flexible office space. In doing so, the Company has been left with significant old debt connected with the construction industry and has incurred new debt to finance its investment in leasing and upgrading office space.

6. Given the nature of the Group's business, the Company has historically found it difficult to obtain loans from larger institutions, and has instead relied on privately arranged short-term, high cost instruments. The Company was hoping to raise new capital from the market to refinance its existing debt with cheaper alternatives in the first quarter of 2020 but the combination of COVID-19, social distancing, and global lockdowns has had an immediate and damaging impact on the Group's business performance, cash generation, and profitability.

7. The most recent financial statements of the Company and the Group were for the year ended 31 July 2018. As such they are now significantly out of date. They were also

subject to a statement of material uncertainty as to whether the Company was, even at that stage, a going concern. There was also a disclaimer of auditor opinion by Grant Thornton who were unable to obtain sufficient audit evidence in respect of transactions, revenues and liabilities. The Company and the Group subsequently extended their accounting year end to 31 December 2019 and have not produced any more up-to-date financial statements.

The Opposing Creditors and the winding-up petition

8. The Company's former chief financial officer, Mr. Rupinder Bains, left the Company on 12 November 2019. After leaving, Mr. Bains and a number of creditors connected with him sought repayment of loans which they had made to the Company, together with interest.

9. Mr. Bains had made loans to the Company totalling US$405,173 in principal amount which were repaid after service of a statutory demand. However, repayment of interest was not forthcoming and so Mr. Bains commenced County Court proceedings against the Company for such interest and for expenses which he claims were incurred on the Company's business. The Company has admitted the interest claim in the sum of US$158,751 as at 25 July 2020, but has defended and counterclaimed in relation to the expenses claims on a variety of grounds.

10. After Mr. Bains' departure, Sumiki Limited, a company owned and controlled by Mr. Bains' brother, also brought County Court proceedings in respect of loans made to the Company. Those claims have now been admitted but have not been paid in a sum which (together with interest) amounted to US$217,975 as at 25 July 2020. In March 2020 three other creditors related to Mr. Bains or his family members, namely Doolally Limited, Gurdeep Lally and Raman Lally, also each served a statutory demand on the Company in respect of unpaid loans and interest which amounted to US$235,897, US$182,393 and US$110,733 respectively as at 25 July 2020.

11. When its loans were not repaid, Doolally Limited presented a winding up petition against the Company on 1 May 2020. The Company sought an injunction to restrain advertisement of that petition on a number of grounds. However, on 1 June 2020 Deputy ICC Judge Agnello QC refused to grant an injunction, holding that there was no genuine and substantial dispute over the debt owed to Doolally Limited and that it had no collateral purpose which made the petition an abuse of process. The Deputy ICC Judge then adjourned consideration of whether an injunction ought nevertheless to be granted on the basis of the anticipated provisions of the Corporate Insolvency and Governance Act 2020 concerning the effect of the COVID-19 pandemic.

12. On 16 June 2020 an injunction restraining advertisement was granted by ICC Judge Barber on the basis that the coronavirus had had a financial effect upon the Company and she was not satisfied that the insolvency test in section 123(1)(e) of the Insolvency Act 1986 would have been met if the coronavirus had not had that effect. The winding up petition was adjourned until 7 October 2020.

13. The sixth Opposing Creditor is Beach Resorts Investment Limited ("BRIL") which is not connected with Mr. Bains or his family members. BRIL is the subscriber and holder of 10% unsecured Loan Notes 2017 issued by the Company, the principal and interest of which is due and unpaid and totalled US$1,482,849 as at 25 July 2020.

The Scheme in outline

14. By the Scheme the Company seeks to effect a debt to equity conversion of the equivalent of about US$18.78 million in principal and accrued interest of debt (the "Scheme Debt") into A1 Ordinary Shares in the Company. Those shares will be issued to Scheme Creditors in proportion to the value of the Scheme Debt they hold on the basis that each US$0.33 of debt will give an entitlement to one A1 Ordinary Share.

15. The definition of the Scheme Debt in the draft Scheme is singularly unclear. It refers to,

> "all loans, bonds and other debt (other than trade debt) as set out in Part 5 of this Scheme document together with interest accrued and/or owing on such Debt up to the date prior to the date the Scheme becomes Effective".

The reference to Part 5 is in fact to a separate part of the composite document that was sent to Scheme Creditors which contains a table of creditor claims that broadly corresponds with the first recital to the Scheme and comprises a wide variety of unsecured loans made to the Company by a number of lenders under various instruments. The Scheme Debt also includes about US$887,250 which is said to be unpaid wages and expense claims owing to Mr. Aldridge and Mr. Sykes.

16. In addition to the conversion to be effected by the Scheme, the Company has entered into a separate consensual agreement with one of the Scheme Creditors, 21st Century Group Holdings Limited ("21st Century"). Under that agreement, an additional US$750,000 of debt owed to 21st Century by one of the Company's subsidiaries, Sunbird Business Services Africa Limited pursuant to an agreement referred to in the documentation as the "Subsidiary Loan Agreement", is to be novated, subject to the Scheme being sanctioned, to become a liability of the Company and will be converted to A1 Ordinary Shares in the Company on the same terms as under the Scheme.

The Rights Issue

17. The debt to equity conversion under the Scheme will not, of itself, be sufficient to enable the Company to survive and to continue to trade. Accordingly, on condition that the Scheme becomes effective, the Company also intends to raise US$3,000,000 in cash through a rights issue of 15,000,000 A1 Ordinary Shares in the Company (the "Rights Issue") at an issue price of US$0.20 per A1 Ordinary Share.

18. The Rights Issue will be fully underwritten by an entity described in the Chairman's letter to Scheme Creditors as "an existing cornerstone investor". That underwriter is in fact Aldridge Capital Limited, which is the holder of about 28% of the Scheme Debt and is an existing holder of A1 Ordinary Shares amounting to about 2% of the issued share capital of the Company. No further description of Aldridge Capital was given in the documentation sent to Scheme Creditors, but it appears to be connected with one of the two Managing Directors, Mr. Aldridge (who I was told at the hearing owns about 9% of its shares) or his father, and is represented on the board of the Company by Mr. Matthew Insley.

19. The terms of the proposed Rights Issue will also allow Aldridge Capital (as underwriter) and the existing shareholders (including Aldridge Capital, the other Scheme Creditors whose debt will be converted under the Scheme, and 21st Century which will acquire A1 Ordinary Shares under the novated Subsidiary Loan Agreement with the Company) who take up their rights to new A1 Ordinary Shares in full, to subscribe for a further equivalent number of A2 Ordinary Shares in the Company at a price of US$0.01 per share. The A2 Ordinary Shares carry equal voting rights to the A1 Ordinary Shares.

The Convening Hearing

20. The Company issued its application under Part 26 of the Act on 16 June 2020, the same day that it obtained an injunction restraining advertisement and an adjournment of Doolally Limited's winding up petition.

21. A convening hearing was listed for 26 June 2020 before ICC Judge Burton (the "Convening Hearing"). In spite of various requests for information concerning the Scheme from some of the Opposing Creditors, the Company did not give notice of the Convening Hearing to any of the Scheme Creditors or suggest that they might wish (or be entitled) to attend.

22. Accordingly, only the Company was represented at the Convening Hearing. The Skeleton Argument for the hearing asserted that the Company,

> "...has been unable to provide advance notification by way of a [letter under the Practice Statement (Companies: Schemes of Arrangement) [2002] 1 WLR 1345] of the convening hearing to the Scheme Creditors because of the urgent need to transact the Scheme bearing in mind, in particular, the winding up applications."

However, neither the Skeleton Argument nor the evidence produced by Mr. Aldridge on behalf of the Company at the Convening Hearing explained that the winding up petition presented by Doolally Limited had been adjourned ten days earlier and was not in fact due to be heard until 7 October 2020.

23. In my judgment, notice of the Convening Hearing could have been given to Scheme Creditors, and certainly should have been given to those who requested details of the Scheme process. Mr. Thornton QC accepted that the consequence of the way in which the Company did not follow the Practice Statement by sending creditors a letter or notifying them of the Convening Hearing was that it "took the risk" of getting things wrong, and that there was no restriction upon the points that could be raised at the sanction hearing by the Opposing Creditors. That is certainly true, but in my judgment it went further than that. As the evidence to which I shall refer below subsequently made clear, by this time the Company was already adopting a very different approach of engagement with selected creditors which it thought might be supportive of its proposals, whilst keeping creditors which it considered might be hostile at arm's length.

24. At the Convening Hearing, ICC Judge Burton convened a single meeting of the Scheme Creditors to be held on 27 July 2020. Her order required the Company to

send a scheme document containing the notice of the meeting and proxy forms, the Scheme and an explanatory statement required by section 897 of the Act to Scheme Creditors at least 21 clear days before the day appointed for the court meeting.

The Scheme Document and Explanatory Statement

25. A document concerning the Scheme (the "Scheme Document") was sent to Scheme Creditors on 3 July 2020 together with the requisite notice of the court meeting and proxy forms. The Scheme Document included a letter from the Chairman of the Company, an explanatory statement purporting to comply with section 897 of the Act (the "Explanatory Statement"), a copy of the Scheme and various pieces of financial and other information concerning the Company, including a copy of the last audited accounts of the Company to 31 July 2018.

26. The Chairman's letter summarised the reasons for the Scheme and the Rights Issue and contained a recommendation of the directors of the Company to Scheme Creditors to vote in favour of the Scheme.

27. The Chairman's letter summarised the effect of the Scheme as follows,

> "Subject to any shares withheld in accordance with UK withholding tax, following the Scheme the Creditors will hold (in their capacity as converted shareholders only), in aggregate 72 per cent. of the issued share capital of SchemeCo (including for the avoidance of doubt shares converted by the Subsidiary Loan Agreement). Following the Rights Issue, if the Creditors took up their rights issue in full (in their capacity as converted shareholders only) they would hold in aggregate 74 per cent. of the issued share capital of SchemeCo. If the Creditors did not take up any of the Rights Issue they would hold (in their capacity as converted shareholders only) in aggregate 69 per cent. of the issued share capital of SchemeCo. It is acknowledged that some of the Creditors are also Shareholders of SchemeCo but for the purposes of this illustration this disregards their existing shareholding as at the date of this document."

28. The Chairman's letter then set out the background and reasons for recommending the Scheme and Rights Issue. This section included the following paragraphs,

> "3.13 The Board believes the Winding-up Petition is not in the best interests of SchemeCo's creditors and will result in very poor recovery for SchemeCo's creditors. The Board believes that if SchemeCo were to enter into an insolvency process, whether administration or liquidation, recovery for lenders and shareholders to SchemeCo will be negligible. Whilst the Board has not commissioned an insolvency practitioner to undertake an analysis of estimated outcomes, the Board believes its view is reasonable on the following basis:

3.13.1 SchemeCo has limited assets, all of which are represented by investments in, and loans to, subsidiaries;

3.13.2 SchemeCo has obligations in its trading subsidiaries which will or are likely to rank in preference to SchemeCo's investments and loans into said subsidiaries; and

3.13.3 the SchemeCo Group has limited assets some of which, such as contracts that it holds with key tenants provide rights of termination on insolvency.

….

3.17 The Directors have considered the various options available and believe that the Debt-for-equity conversion, whereby each Creditor would convert its Debt into A1 Ordinary Shares at a price of US$0.33 per share, together with the Rights Issue, is in the interests of all the Creditors and the Shareholders and would ensure SchemeCo has a stable base going forward and would likely provide the Creditors with a preferable return to the value they would receive if SchemeCo went into liquidation."

29. After setting out proposals for changes to the management of the Company, the Chairman's letter contained two sections entitled "Valuation Methodology" and "Rights Issue" which I should set out in full.

"6. VALUATION METHODOLOGY

6.1 SchemeCo has considered the likely recoveries by the Creditors in the event that the Winding-up Petition is successful and SchemeCo is wound up along with its subsidiaries. Whilst SchemeCo has not hired an insolvency practitioner to undertake an analysis of estimated outcomes, SchemeCo believes its view is reasonable on the following basis. SchemeCo has limited assets, all of which are represented by investments in, and loans to, subsidiaries. SchemeCo has obligations in its trading subsidiaries which will or are likely to rank in preference to the SchemeCo's investments and loans into said subsidiaries and finally the SchemeCo Group has limited assets, some of which, such as contracts that it holds with key tenants provide rights of termination on insolvency.

6.2 On the basis of the Creditors in the subsidiaries, the jurisdictions involved and the available assets, the directors have oncluded that the recovery will be very low for the Creditors in SchemeCo.

6.3 To determine the Debt-for-equity Conversion price and Rights Issue price, the Board undertook a valuation of SchemeCo as a going concern. Such valuation was undertaken

on the basis that the Scheme becomes effective and insolvency of SchemeCo is avoided.

6.4 Given the size, nature and jurisdiction of SchemeCo and the state of its financial distress it is difficult to apply an accurate valuation. However, a desk multiple is a generally accepted valuation metric for this sector. SchemeCo has considered comparable businesses in the sector and the desk multiples applied to them. From taking a sample of five compatibles SchemeCo has arrived at an industry median desk value.

6.5 SchemeCo has then applied a discount to this desk valuation on the grounds of its geographic location, Covid-19, its own financial distress and has stripped out future desks and the growth premium associated with this. Whilst SchemeCo is able to fund from earnings the build of a small number of desks, it does not have the funds to fund substantial growth in the near term.

6.6 SchemeCo considers a discount of between 45 per cent. – 50 per cent. to the median is appropriate in the current circumstances.

6.7 The Board has commissioned an independent to review its valuation methodology and key assumptions which supports its approach.

7. RIGHTS ISSUE

It is proposed that on or around the time the Scheme becomes Effective, there will be a rights issue whereby the holders of A1 Ordinary Shares and A2 Ordinary Shares, including the Creditors following their conversion into equity, will be offered the right to subscribe for up to 15,000,000 A1 Ordinary Shares at a price of US$0.20 per share, being the issue price ("Rights Issue"). The Rights Issue will be fully underwritten by an existing cornerstone investor in accordance with the Underwriting Agreement. In addition, in accordance with the SchemeCo Articles, members who are owners of A1 Ordinary Shares and who take up their full pro rata entitlement (or more) under the Rights Issue will be offered the opportunity to purchase A2 Ordinary Shares up to the amount of A1 Ordinary shares that they have subscribed for as part of the Rights Issue. It is proposed that the Rights Issue will be launched on or after the date the Scheme becomes Effective. Further details of the Rights Issue will be provided to all members, including the Creditors, in due course."

30. The Chairman's letter then set out what was said to be the effect of the Scheme and Rights Issue on an unaudited balance sheet of the Company as at 30 April 2020. The

balance sheet contained a line for "Investments" at US$5,952,000 and "Trade & other Receivables" at US$3,958,000, and can be summarised as follows,

US$'000

	As at 30 April 2020	Assuming Scheme	Assuming Rights Issue
Non-current assets	5,953	5,953	5,953
Current assets	3,990	4,740	7,078
Total Assets	9,943	10,693	13,032
Current Liabilities	19,494	738	49
Net Current Assets (Liabilities)	(15,504)	4,002	7,030
Non-current liabilities	240	240	240
Net Assets (Liabilities)	(9,791)	9,715	12,743

31. After dealing with the existing litigation against the Company, the letter then contained a further section as follows,

> "10. WHAT WILL HAPPEN IF THE SCHEME IS NOT SANCTIONED
>
> 10.1 If the Scheme is not sanctioned the Underwriting Agreement and the Rights Issue will fall away SchemeCo will not be able to raise the necessary funding to continue. The winding up petitions will likely continue to proceed and may result in the liquidation of SchemeCo.
>
> 10.2 The Board believes that if SchemeCo is unable to restructure its balance sheet in very short order, it is inevitable that SchemeCo will cease trading and enter into an insolvency procedure. Following such a process, the Board believes that the Creditors recovery will be negligible and the amount they would receive would be subject to uncertainty and delay. In that eventuality there would be no return for shareholders."

32. Apart from the 2018 accounts which were contained in an Appendix, the paragraphs set out above were the sum total of the financial information and financial analysis provided to Scheme Creditors concerning the Scheme and Rights Issue.

33. The letter from the Chairman was followed by the Explanatory Statement itself. That was a short document which summarised the bare terms and mechanics of the Scheme

and the process to be followed at the meeting but contained no other material financial information.

34. The Explanatory Statement also purported to contain a statement of the interests of the directors in the Scheme Debt and the effects of the Scheme upon them in the following terms,

> "THE DIRECTORS OF SCHEMECO AND THE EFFECT OF THE SCHEME ON THEIR INTERESTS
>
> The names of the Directors and the details of their interests in Debt are set out in paragraph 5 of Part 5 of this document.
>
> Save as disclosed in this document, the effect of the Scheme on such interests of the Directors does not differ from its effect on the like interests of any other person."

35. The reference to paragraph 5 of Part 5 was, however, to a table summarising the composition of the Scheme Debt by general description and amount. Although the directors were listed by name in another paragraph of Part 5, there was in fact no statement of their interests in any of the Scheme Debt, nor of their interests in the existing shares in the Company.

Adjournment of the Scheme meeting and circulation of the Addendum

36. Very shortly after the Scheme Document and Explanatory Statement had been circulated, the Opposing Creditors and their solicitors sent a number of detailed emails and letters to the Company protesting that the information provided to Scheme Creditors was wholly inadequate and insufficient to enable them to make an informed decision on the merits of the Scheme. Among issues raised were the lack of any statement as to the interests of the directors; the lack of up-to-date financial information; the lack of any detail or supporting material concerning the "valuation methodology" or the independent adviser who had supposedly reviewed the methodology and assumptions and supported the board's approach; the lack of any estimated outcome statement for a liquidation as an alternative to the Scheme; and the lack of any information or supporting material concerning the terms of the Rights Issue or the underwriting agreement with Aldridge Capital.

37. After receipt of these letters, and in particular a letter dated 24 July 2020 from the solicitors for the Opposing Creditors, on 27 July 2020 the Chairman of the Company decided to adjourn the court meeting to 17 August 2020 to enable the Company to provide further information to Scheme Creditors responding to the questions that had been raised.

38. That response was provided by the Company way of a document entitled "Addendum to Scheme Circular" (the "Addendum"). It was circulated to Scheme Creditors on 6 August 2020, i.e. only 11 days before the date of the adjourned court meeting rather than the 21 clear days specified in the order of ICC Judge Burton.

39. The Addendum first addressed the position of the Company and the Group,

"2.2 As a reminder to Creditors, the SchemeCo Group is a focussed provider of flexible office space. SchemeCo itself is a holding company with its assets consisting almost entirely of equity investments in, and loans to, its subsidiaries. All revenue of the SchemeCo Group is generated by SchemeCo's operating subsidiaries and it is these subsidiaries that hold the SchemeCo Group's trading assets. Those assets, excluding intercompany loans, consist of assets largely made up of office equipment, some of which are leased, fixtures and fittings, certain tax assets, customer contracts and prepayments and leases over premises.

2.3 However, on a going concern basis, the combined balance sheets as at 30 April 2020 of the trading subsidiaries of the SchemeCo Group show net liabilities.

2.4 All of the trading companies of the SchemeCo Group have been supported through injections of equity and debt into them from SchemeCo and it is likely that the trading subsidiaries will be reliant on parent company support for the foreseeable future….

….

2.6 Given that the trading subsidiaries of the SchemeCo Group have been dependant on parent company support to date and will continue to be so as explained above for the foreseeable future, in the event of a liquidation of SchemeCo (or in any other circumstances where that support was not forthcoming) it is highly likely – almost certain – that the trading companies would also fall into liquidation. As set out above, on a going concern basis the combined balance sheets as at 30 April 2020 of the trading subsidiaries of SchemeCo Group show net liabilities and as such any recovery up to the SchemeCo will be limited.

….

2.8 The Directors believe that it is highly unlikely that the trading assets would give rise to a material recovery in the event of a liquidation of each subsidiary. Each of the leases to which SchemeCo's subsidiaries are parties would be likely to be terminated by the landlords who would be entitled to retain rent deposits and then prove for additional sums in the liquidations. In relation to the other assets of the trading companies, they consist of items such as desks, chairs, computer hardware and other office equipment physically located at the various locations at which the trading companies operate and would be unlikely to realise significant value.

> 2.9 In short, without restructuring SchemeCo's balance sheet and obtaining an immediate cash injection, the business operated by the SchemeCo Group will no longer be able to continue trading. If these issues are addressed, in the Directors' reasonable opinion, the SchemeCo Group can become cash flow positive within the next 12 months' and the SchemeCo Group will be able to continue to trade going forward, thereby creating value for its stakeholders, including, in particular, the Scheme Creditors. The Directors continue to believe that, absence successful completion of the Scheme and the Rights Issue, SchemeCo and the members of its group will fall into liquidation with a negligible return for the SchemeCo Creditors."

40. The Addendum then contained a number of sections addressing other issues. These included the following,

> "*Board decision making*
>
> 2.10 The Directors sought independent third-party legal, commercial and financial advice when it was determined to be necessary for the purposes of considering the range of options available to the SchemeCo Group, to improve its financial position and start to generate a positive cashflow. The Directors then exercised their commercial judgement in making decisions regarding the Scheme and the Rights Issue, taking this advice into account. All the Directors voted in favour and support the Scheme and Rights Issue, including one independent director with no interest in the debt or equity of SchemeCo and who receives no remuneration for their services to the Company.
>
> *Subsidiaries*
>
> 2.11 As set out in the Scheme Document, SchemeCo has limited assets, most of which are represented by equity investments in, and loans to, its subsidiaries. As explained above, the nature of the financing of the trading subsidiaries together with their asset make-up is highly likely to mean that a liquidation of SchemeCo would result in a liquidation of each of the subsidiaries with limited recovery from the relevant subsidiaries' asset base. In addition, on a going concern basis, the combined balance sheets as at 30 April 2020 of the trading subsidiaries of the SchemeCo Group show net liabilities and as such any recovery up to the SchemeCo will be limited.
>
> 2.12 There is a further factor that will operate to impact on the ability of SchemeCo to recover material sums from the SchemeCo Group's trading subsidiaries in the event of the SchemeCo Group's trading subsidiaries falling into insolvency. A number of the creditors of SchemeCo Group's trading subsidiaries would rank in priority to SchemeCo as a creditor in

the subsidiaries concerned. Where there are intercompany loans (i.e. from SchemeCo to its subsidiaries), these are subordinated to certain types of claims referred to in paragraph 2.13 below and in the parts of the African continent where most members of the SchemeCo Group operate, intercompany loans are usually classified as loans from connected parties and subordinated to other creditors. In the circumstances where they are not subordinated, they will rank alongside amounts owed to a substantial number of other local creditors, including landlords (as referred to in paragraph 2.13 below), thereby limiting potential recovery by SchemeCo.

2.13 As explained above, SchemeCo's subsidiaries owe a substantial amount to landlords in rent, payment of approximately US$468,000 which has been included in SchemeCo's forecasts to be paid from the proceeds of the Rights Issue. In an insolvency, these would form a significant claim and landlords would likely seize rent deposits and offset these amounts against historic amounts overdue and future obligations. An insolvency will unlikely act to limit the landlords claim for future unpaid amounts of the lease. Certain obligations to pay local taxes and employees as well as landlords claims to rent deposits would rank ahead of obligations to both secured and unsecured creditors of SchemeCo's subsidiaries.

….

Assessment of outcomes for creditors

2.22 As set out above and in the Scheme Document, SchemeCo has very few realisable assets and substantial debts (see page 15, paragraph 6.1 of the Scheme Document). A balance sheet of SchemeCo is set out at page 33, paragraph 7 of the Scheme Document. Even when assessed on the basis of a going concern, the unaudited balance sheet as at 30 April 2020 showed net liabilities. Net liabilities are likely to substantially increase in the event of a liquidation of SchemeCo (and its subsidiaries) as more particularly explained above.

2.23 The Directors' assessment of recoveries in an insolvency process is set out in the Scheme Document. Given the nature of the business of the SchemeCo Group, the composition of its balance sheet and impact of the trading subsidiaries being deprived of additional financing, recoveries will likely be extremely low (see page 13, paragraph 3.13 of the Scheme Document). Using the valuation methodology set out in the Scheme Document, the shares issued to Creditors will have substantially greater value than the results achieved by such Creditors in an insolvency process.

…

Valuation

2.26 As set out at page 15, paragraph 6 of the Scheme Document, the Board undertook a valuation of SchemeCo as a going concern, based on applying a desk multiple (generally accepted valuation metric for this sector) and applying a discount to this desk valuation on the grounds of SchemeCo's geographic location, Covid-19, its own financial distress and stripping out future desks and the growth premium associated with this. The number of desks used to calculate the valuation is the current number of desks available plus the additional number that are planned in the expansion spaces that some of the proceeds of the Rights Issue will be used to build. The Directors' considered a discount of between 45 per cent. – 50 per cent. to the median was appropriate in the current circumstances.

2.27 The discount applied is attributable to various factors including the size of the business, the geographical location of the business and its current financial position of distress. The effects of Covid-19 on its customers and SchemeCo's inability to grow in the near term at the kind of pace which a high multiple would demand.

Rights Issue

2.28 A question has been asked as to why the Rights Issue is being priced at a level below the price being applied under the Scheme (namely, US$0.20 per share under the Rights Issue and US$0.33 per share under the Scheme). In light of the above paragraph concerning valuation and the imperative to ensure the Rights Issue was fully underwritten and the funds available, it is common market practice to offer rights issues at a discount, there being examples of discounts being as large as 80%. A discount of 40% was deemed to be fair and reasonable to Creditors by the Directors and the Directors exercised their commercial judgement in concluding this. The application of the discount was applied to encourage shareholders (including the converted Creditors) to take up their rights issue. The application of discounts was considered and verified with the SchemeCo Group's third-party advisers.

…

2.31 Any outstanding costs of the Scheme, the Rights Issue and the restructuring will be paid out of the proceeds of the Rights Issue. The total cost of the Scheme, Rights Issue and restructuring, including professional fees, is estimated to be approximately US$500,000."

41. The Addendum then contained a section headed "Directors' Interests in Shares and Debt" which set out in tabular form the interests of each of the directors of the Company in the Scheme Debt and in the existing shares in the Company. The table also included a section showing the interests which the directors would have in shares immediately following the Scheme becoming effective.

42. The table showed that three of the directors personally and three further entities connected with or represented by three of the other directors held Scheme Debt which together amounted to 51% of the total Scheme Debt. It also showed that all but one of the directors and the connected persons held A1 Ordinary or A2 Ordinary shares in the Company amounting in aggregate to 47% of the issued shares in the Company. In particular, Mr. Aldridge, Mr. Sykes and Aldridge Capital held respectively 7%, 5% and 28% (i.e. a total of 40%) of the Scheme Debt and respectively 18%, 16% and 2% (i.e. a total of 36%) of the existing share capital of the Company.

43. The table also showed that, following the Scheme becoming effective, the board members and the connected parties would together hold 49% of the issued share capital of the Company, with Mr. Aldridge, Mr. Sykes and Aldridge Capital respectively holding 9%, 7% and 21% (i.e. a total of 37%) of the issued shares.

44. There then followed a second table which showed that, assuming that the directors and connected parties elected to take up their rights in full, they would each retain the same proportion of shares in the Company following the Rights Issue. A footnote to that table stated that if the other directors did not take up their rights, the maximum number of shares that Aldridge Capital could itself hold following completion of the Rights Issue would equate to 38% of the issued share capital of the Company.

The Court Meeting

45. The court meeting was held on 17 August 2020. The report of the Chairman indicates that the meeting was attended in person or by proxy by 30 of the 32 Scheme Creditors, and that these creditors represented 99% of the Scheme Debt. Of the Scheme Creditors voting, 24 Scheme Creditors holding 87% by value voted in favour of the Scheme, and the 6 Opposing Creditors voted against, holding 13% by value.

46. The Chairman's report also indicated that if the directors and those Scheme Creditors represented by the directors had not voted, the majority in favour of the Scheme would have been 73% by value, and the vote against would have been 27%. The report further indicated that of the Scheme Creditors who are not existing shareholders in the Company, 74% voted in favour of the Scheme and 26% voted against.

The Grounds of Opposition

47. The Opposing Creditors do not challenge the composition of the single class of Scheme Creditors. They do, however, contend that the information provided to Scheme Creditors in the Scheme Document (which included the Explanatory Statement) and Addendum was materially inadequate and misleading in a number of respects, and that this was very much of a piece with the way that the Company failed to engage with all Scheme Creditors in relation to the Convening Hearing.

48. In particular, the Opposing Creditors contend,

    i) that the Explanatory Statement circulated to Scheme Creditors with the notice of the Scheme Meeting failed to contain a statement of the interests of the directors as required by section 897(2)(b) of the Act; and that the Addendum containing the required information was circulated less than the minimum 21 days before the Scheme Meeting required by the Convening Order;

    ii) that the Scheme Document and Addendum failed to provide sufficient information so as to enable Scheme Creditors to form a reasonable view of the merits or otherwise of the Scheme, and in particular did not contain (a) a sufficient explanation of the alternative to the Scheme which should have included a liquidation analysis for the Group to support an estimated outcome statement for Scheme Creditors, (b) a sufficient explanation of the basis for the pricing of the debt to equity conversion under the Scheme, (c) a sufficient explanation of the basis for the pricing of the associated Rights Issue, or (d) any indicative value of the Ordinary Shares which Scheme Creditors would receive in the Company; and

    iii) that in relation to the potentially dilutive effect on Scheme Creditors of the Rights Issue, the Scheme Document was positively misleading.

<u>The Law</u>

49. Schemes of arrangement under Part 26 provide a flexible means by which companies in financial difficulties can be restructured with the consent of the specified majorities of their creditors and the sanction of the court. The statutory power to bind a dissentient minority to a scheme supported by the requisite majorities in order to give a struggling company a prospect of survival rather than collapse into formal insolvency is particularly valuable in the current uncertain economic climate. But from the earliest days of the scheme jurisdiction it has been repeatedly emphasised that, to use the words of Bowen LJ in <u>Re Sovereign Life Assurance Company v Dodd</u> [1892] 2 QB 573 at 583, the scheme jurisdiction represents "a most formidable compulsion upon dissentient, or would be dissentient creditors".

50. As a consequence, the scheme jurisdiction and procedure contains a number of important safeguards to ensure that if the rights of dissentient creditors are to be modified or extinguished without their consent, this only takes place fairly and in accordance with due process. These safeguards include, at the convening stage, the jurisdictional requirement for creditors to be separated into different classes for voting purposes where their rights (either as against the scheme company or offered to them under the scheme) are sufficiently dissimilar that they cannot consult together in their common interest.

51. Secondly, and has also been repeatedly stressed, at the sanction stage, the court does not simply act as a "rubber-stamp" for the wishes of the majority as expressed at the court meeting. The decision of the meeting in favour of a scheme represents a threshold that must be surmounted before the sanction of the court can be sought, but in deciding whether to sanction the scheme or not, the court exercises an important discretion which provides a safeguard against oppression of the minority: see per Chadwick LJ in <u>Re BTR plc</u> [2000] 1 BCLC 740 at 747g.

52. The classic approach of the court to the exercise of this discretion was described by David Richards J in Re Telewest Communications plc (No.2) [2005] 1 BCLC 772 at [20]-[22] as follows,

> "20. The classic formulation of the principles which guide the court in considering whether to sanction a scheme was set out by Plowman J in Re National Bank Ltd [1966] 1 WLR 819 by reference to a passage in *Buckley on the Companies Acts*, which has been approved and applied by the courts on many subsequent occasions:
>
> > "In exercising its power of sanction the court will see, first, that the provisions of the statute have been complied with, second that the class was fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent, and thirdly, that the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve.
> >
> > The court does not sit merely to see that the majority are acting bona fide and thereupon to register the decision of the meeting, but, at the same time, the court will be slow to differ from the meeting, unless either the class has not been properly consulted, or the meeting has not considered the matter with a view to the interests of the class which it is empowered to bind, or some blot is found in the scheme."
>
> 21. This formulation in particular recognises and balances two important factors. First, in deciding to sanction a scheme under section 425, which has the effect of binding members or creditors who have voted against the scheme or abstained as well as those who voted in its favour, the court must be satisfied that it is a fair scheme. It must be a scheme that "an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve." That test also makes clear that the scheme proposed need not be the only fair scheme or even, in the court's view, the best scheme. Necessarily there may be reasonable differences of view on these issues.
>
> 22. The second factor recognised by the above-cited passage is that in commercial matters members or creditors are much better judges of their own interests than the courts. Subject to the qualifications set out in the second paragraph, the court "will be slow to differ from the meeting".

53. The reference by David Richards J to the qualifications set out in the second paragraph of the extract from *Buckley on the Companies Acts* relevantly include, for present purposes, the requirement that the class of creditors must have been "properly consulted". In this respect, the origins of the text in *Buckley* are to be found in the judgment of Lindley LJ in the Court of Appeal in Re English, Scottish and Australian Chartered Bank [1893] 3 Ch 385 at page 408-409,

> "Now, it is quite obvious from the language of the Act and from the mode in which it has been interpreted, that the Court does not simply register the resolution come to by the creditors or the shareholders, as the case may be. If the creditors are acting on sufficient information and with time to consider what they are about, and are acting honestly, they are, I apprehend, much better judges of what is to their commercial advantage than the Court can be. I do not say it is conclusive, because there might be some blot in a scheme which had passed that had been unobserved and which was pointed out later.
>
> While, therefore, I protest that we are not to register their decisions, but to see that they have been properly convened and have been properly consulted, and have considered the matter from a proper point of view, that is, with a view to the interests of the class to which they belong and are empowered to bind, the Court ought to be slow to differ from them. It should do so without hesitation if there is anything wrong; but it ought not to do so, in my judgment, unless something is brought to the attention of the Court to shew that there has been some material oversight or miscarriage."

54. In determining what amounts to "proper consultation", the starting point is section 897(1) of the Act which provides that every notice summoning a meeting of creditors convened by the court under section 896 must be accompanied by a statement complying with section 897. Section 897(2) then provides,

> "The statement must—
>
> (a) explain the effect of the compromise or arrangement, and
>
> (b) in particular, state—
>
> (i) any material interests of the directors of the company (whether as directors or as members or as creditors of the company or otherwise), and
>
> (ii) the effect on those interests of the compromise or arrangement, in so far as it is different from the effect on the like interests of other persons."

55. These provisions are supplemented by paragraphs 14 and 15 of the new Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the

Companies Act 2006) which came into force on the day of the Convening Hearing and which provide as follows,

> "14. Explanatory statements should be in a form and style appropriate to the circumstances of the case, including the nature of the member and/or creditor constituency, and should be as concise as the circumstances admit. In addition to complying with the provisions of section 897 … the commercial impact of the scheme must be explained and members and/or creditors must be provided with such information as is reasonably necessary to enable them to make an informed decision as to whether or not the scheme is in their interests, and on how to vote on the scheme. Where a document is incorporated into the explanatory statement by reference, readers should be directed to the material part(s) of the document.
>
> 15. The court will consider the adequacy of the explanatory statement at the convening hearing. The court may refuse to make a meetings order if it considers that the explanatory statement is not in an appropriate form. However, the court will not approve the explanatory statement at the convening hearing, and it will remain open to any person affected by the scheme to raise issues as to its adequacy at the sanction hearing."

56. The references in the new Practice Statement to the need for an explanatory statement to provide creditors with an explanation of the commercial impact of the scheme and "such information as is reasonably necessary to enable them to make an informed decision as to whether or not the scheme is in their interests" reflect existing case law.

57. So, for example, in Re Heron International NV [1994] 1 BCLC 667 at 672g-i, Nicholls V-C said,

> "The second principal head of complaint relates to the absence of sufficient information to enable a creditor to exercise a reasonable judgment on whether the schemes are in his interest or not. An explanation of the effects of the schemes requires an explanation of how the schemes will affect a bond holder or creditor commercially. He needs to be given such up-to-date information as can reasonably be provided on what he can expect under the schemes … The extent of the information required to be supplied depends on the facts of the particular case…."

58. Likewise, in Re Ophir Energy plc [2019] EWHC 1278 (Ch) at [22] I observed,

> "The basic requirement is that an explanatory statement must be circulated to the members or creditors affected by a scheme, and that it must contain all the information necessary to enable such members or creditors to form a reasonable judgment on

> whether the scheme is in their interests or not, and hence how to vote: see e.g. Re Dorman Long & Co. Limited [1934] Ch 635 at 657; and Re Heron International [1994] 1 BCLC 667 at 672. The extent of the information required to be supplied will of course depend upon the facts of the particular case. But the process under Part 26 of the Act depends upon full and accurate information being provided to those who are to vote upon the scheme, so that if the members or creditors have been provided with materially inaccurate, incomplete or otherwise inadequate information, the Court will most likely not be able to place any reliance upon, or give effect to, an affirmative vote at the Court meeting."

59. In the context of a scheme for creditors which is put forward as an alternative to a formal insolvency process, it is certainly conventional for the scheme company to seek to fulfil these information requirements by putting forward a detailed analysis which estimates the likely returns for scheme creditors in such an insolvency and under the scheme, together with the likely timescales for such recoveries. That is because the reasonable creditor deciding how to vote, and the court which is asked to exercise its discretion to sanction the scheme in the interests of all creditors, will at the very least require to be satisfied that all creditors are being offered a realistic prospect of receiving a greater or faster return under the scheme than they are likely to receive in the alternative if the scheme is not sanctioned: see per David Richards J in Re T&N Limited [2005] 2 BCLC 488 at [82] and my own observations to similar effect in Re Noble Group [2019] BCC 349 at [90].

60. But that is the bare minimum. The reasonable creditor will also want to be provided with the necessary information to understand how any different groups of creditors and any other relevant stakeholders are treated under the scheme and in any wider restructuring in order that he can reach an informed view upon whether the losses which have been suffered and the available value are being appropriately allocated between stakeholder groups.

61. So, for example, if creditors which would rank equally in a formal insolvency are being differently treated under the scheme, or are being left out of the scheme altogether so that they are not being required to accept a compromise of their claims at all, this should be fully disclosed and properly explained: see Virgin Atlantic Airways Limited [2020] EWHC 2376 (Ch) at [63].

62. Such factors will also be particularly relevant in a scheme or restructuring such as the instant case in which the existing shareholders, who would, by definition, receive nothing in a formal insolvency, are being permitted to retain a material stake in the restructured company. In such a case it is likely to be essential for the scheme company to provide a detailed statement of the underlying assumptions and valuation methodology that are said to justify such an outcome so that creditors can reasonably assess, objectively, whether the allocation of losses and the division of benefits among stakeholders is appropriate and fair.

63. It is also self-evident that to enable a reasonable creditor to assess the fairness of a scheme devised by the directors and the reliability of their recommendation of it, the creditor must have a full understanding of the relevant financial and commercial

interests of the directors. That is particularly so in a case in which the directors are interested, whether personally or through third parties with which they are connected, in a number of different capacities, e.g. by being creditors, shareholders, employees or the providers of interim or further finance to the restructured company. These factors are the obvious basis for the statutory requirement that the explanatory statement circulated with the notice of the scheme meeting(s) must include a statement of the interests of the directors.

64. In addition, if directors who are personally interested seek to buttress their proposals and recommendations of a scheme by reference to the views of an independent person, including in particular a professional adviser or expert, it seems to me that the explanatory statement should be open and transparent about the identity and nature of that person. If that person is put forward as an independent professional adviser or expert, the explanatory statement should also make clear the terms and basis upon which he has given his advice or opinion, and whether or not he is prepared to accept responsibility (and hence owe a duty of care) for the opinion to scheme creditors.

65. So it was, for example, that in Re Indah Kiat International [2016] BCC 418 I found that the manner in which the draft explanatory statement failed to give a proper explanation of the true identity and involvement of a supposedly independent creditor, whose support for the scheme was used to buttress the recommendation of the sole director, was deeply unsatisfactory: see paragraphs [47]-[57]. I also indicated, at paragraph [78] that where a so-called "fairness opinion" on the terms of the scheme had been obtained from a firm of consultant accountants by the scheme company and its parent (which appeared to be solvent but would have benefitted from a release from its debts under the scheme), the explanatory statement should have made clear whether the consultant accountants were prepared to accept responsibility to scheme creditors for that opinion.

Analysis

The statement of the interests of the directors

66. It is not in dispute that the Explanatory Statement which was circulated to Scheme Creditors together with the notice of meeting on 3 July 2020 failed to include the required statement of the interests of the directors. If section 897(1)(a) is read literally, this would mean that the Act was not complied with because the Explanatory Statement that accompanied the notice of the meeting did not comply with section 897(2)(b)(i). On that narrow reading of the statute, the omission in the Explanatory Statement could not be corrected by the circulation at any later time of a second document containing the necessary information. Further, since the requirements of section 897 go to jurisdiction, the court could not waive compliance with the terms of the section, and the court would have no jurisdiction to sanction the Scheme.

67. I do not, however, consider that section 897 should be read literally in such a restrictive way. In my judgment it is permissible to read section 897 purposively so that the requirement that the notice of meeting "be accompanied by" an explanatory statement is intended to set up the requirement for there to be an explanatory statement and to indicate when it should be circulated in the normal course of events. But I do not think that the wording of the statute is intended to exclude the possibility of the explanatory statement being supplemented by a further document in an

appropriate case. It would, for example, defeat the obvious purpose of the section (to ensure that creditors are fully informed in a timely manner) if creditors could not be provided with up-to-date information by way of an addendum in a case in which there had been a material change of circumstances after dispatch of the initial explanatory statement.

68. I do consider, however, that bearing in mind that it is the court that orders a meeting to be summoned under section 896 (rather than the company doing so of its own volition) where a supplemental circular is needed to make good a material omission in the original explanatory statement, that supplemental circular should either be sent to creditors so as to comply with the notice period prior to the meeting as specified in the convening order or, if that is not possible, that a further order or directions should be sought from the court. Neither occurred in this case: the Addendum was not sent to Scheme Creditors at least 21 clear days prior to the date of either the original meeting as required by the order of ICC Judge Burton, or prior to the date of the adjourned meeting, and no second order was sought from the court.

69. Accordingly, if I am to sanction the Scheme, I would be required to exercise my discretion to waive the Company's failure to comply with ICC Judge Burton's order.

70. If all other things were equal and this was the only defect in the scheme process, I might well have been inclined to take the view that the fact that the Scheme Creditors were not given the necessary information about the interests of those proposing the Scheme until about 10 clear days before the vote would not have made any difference to the outcome.

71. As it is, for the reasons that follow, I do not think that Scheme Creditors were provided with full and accurate information concerning the Scheme, and I do not have sufficient confidence in the majority vote to take the view that this additional failure in the process of consultation of Scheme Creditors made no difference to the result.

The prospects for recovery of Scheme Debts in an insolvency

72. The only up-to-date financial information concerning the Company was the unaudited and simplified balance sheet as at 30 April 2020. This showed that the Company had total assets of US$9.943 million consisting of investments in subsidiaries and "trade and other receivables". Notwithstanding that figure, the Scheme Document and Addendum asserted that the directors had concluded that if the Company was wound up, the subsidiaries would follow into formal insolvencies, and that this would result in what was variously described as a "negligible" or "very low" recovery by the Company from its subsidiaries and hence a similar return to Scheme Creditors.

73. The Scheme Document and Addendum essentially gave three reasons, in narrative and not entirely consistent terms, to support these views:

    i) the Scheme Document stated that the assets of the subsidiaries were "limited". The Addendum stated that the assets consisted of assets "largely made up of office equipment, some of which are leased, fixtures and fittings, certain tax assets, customer contracts and prepayments and leases over premises";

ii) the Scheme Document stated that "some" of the contracts of the subsidiaries contained termination rights on insolvency. The Addendum expanded upon this statement, indicating that "Each of the leases to which [the Company's] subsidiaries are parties would be likely to be terminated by the landlords" and that "landlords would likely seize rent deposits" and set them off against existing rent arrears which were said to be approximately US$468,000. It was also said that landlords would be likely to claim for future rents and that "an insolvency will unlikely act to limit the landlord's claim for future unpaid amounts of the lease"; and

iii) the Scheme Document asserted that there were unspecified obligations in the trading subsidiaries "which will or are likely to" rank in preference to the obligations owed to the Company. The Addendum stated that "Certain obligations to pay local taxes and employees as well as landlords' claims to rent deposits would rank ahead of obligations to both secured and unsecured creditors of the [Company's] subsidiaries".

74. There was, however, no further specific information to support any of these statements. So, for example, there was no indication of the size of the rent deposits provided by any of the subsidiaries or the rentals payable. Nor was there any explanation of why, in any of the jurisdictions in which the subsidiaries operated, landlords who would have exercised a right to terminate the leases would also be allowed to prove in the liquidation for the full future rentals without, for example, taking into account the possibility of re-letting. Nor was there any quantification of the local obligations which it was said would be preferential in a liquidation.

75. The Scheme Document also gave no specific information whatever as to the balance sheets of the individual subsidiaries, or whether the Company might make a recovery from some of them even though others might be insolvent. The Addendum simply stated that "on a going concern basis, the <u>combined</u> balance sheets as at 30 April 2020 of the trading subsidiaries of the SchemeCo Group show net liabilities and as such any recovery up to the SchemeCo will be limited" (my emphasis).

76. In short, neither the Explanatory Statement nor the Addendum provided any specific financial information or company-by-company detail from which Scheme Creditors could themselves evaluate in any meaningful way whether the views of the directors, as portrayed in the Scheme Document or Addendum, were objectively justified on the facts.

77. Further, and importantly given the lack of any specific information from which Scheme Creditors could themselves form a view, the directors' assertions were not independently verified by an insolvency practitioner or other suitable professional. Although the Scheme Document stated that this had not been done, there was no explanation of why that was the case.

78. In his subsequent evidence on behalf of the Company, Mr. Matthew Insley indicated that the decision not to instruct an independent insolvency practitioner was taken because (i) the directors thought that the position was clear, (ii) the Company already had "indications of the level of support for the Scheme", and (iii) the Company was under time pressures to launch the Scheme due to the winding-up petition.

79. None of those reasons withstands scrutiny: (i) the fact that the directors subjectively thought that the position was clear does not mean that their views did not need to be independently verified so that Scheme Creditors might have some objective material upon which to form a judgment on the Scheme; (ii) the fact that the directors might have been able informally to garner support from some creditors in advance of the Scheme being launched does not relieve the Company of its obligations to provide appropriate information to all Scheme Creditors in an explanatory statement, and (iii) as I have already made clear, the winding-up petition by Doolally Limited had been adjourned for a lengthy period some time before the Convening Hearing and even longer before the circulation of the Scheme Document.

80. Both the lack of any independent verification or any coherent explanation for that are striking omissions given that the Company apparently did instruct someone to verify its "Valuation Methodology" for pricing the debt to equity conversion (see below) and was apparently willing to spend the very substantial sum of approximately US$500,000 on the costs (including professional fees) of the Scheme, the Rights Issue and the restructuring: see paragraph 2.31 of the Addendum (above).

81. In essence, the Scheme Document and Addendum simply left the Scheme Creditors to trust the word of the directors as to the prospects for recovery of their debts in the absence of the Scheme. I do not consider that was an appropriate basis upon which a reasonable Scheme Creditor could reach an *informed* view on this essential element of the question of whether the Scheme was in their interests.

82. That state of affairs is made all the more unsatisfactory when tested against the evidence, verified by a statement of truth, which Mr. Aldridge had provided in opposition to the winding-up petition presented by Doolally Limited in March 2020. In that evidence, Mr. Aldridge stated,

> "The [Company's] present value in a forced sale in liquidation scenario would be less than US$5 million, given it is a commercial property management provider in a Covid-19 situation, which would be taken up entirely by paying off its secured creditors and preferential creditors (mainly staff). It has around US$18 million of unsecured creditors, who would likely realise nothing in the liquidation. Once the present pandemic passes and lockdowns relax and normal business resumes, in due course the [Company's] value will increase from the above."

83. On its face, that statement suggests that the realisable value of the Company's assets in a liquidation could amount to up to US$5 million. That is materially different from "negligible" or "very low". Although the witness statement asserted that such realisations would be taken up entirely by paying secured and preferential creditors of the Company, there is no mention of any such creditors in the Scheme Document.

84. Even assuming that the reference in Mr. Aldridge's witness statement might have been an inaccurate reference to the secured and preferential creditors of the subsidiary companies rather than of the Company itself, it is not remotely clear to me how the statement that the forced sale of the assets of the subsidiaries might realise up to US$5 million can be reconciled with the statements in the Scheme Document as to the very

limited nature and negligible value of those assets. Nor is it at all clear why all of such value would then be taken up by paying the claims of landlords and staff of those companies.

The price for the debt to equity conversion and the Rights Issue

85. The Scheme Document and Addendum contained no financial information to support the bland description in paragraphs 6.4 to 6.6 of the Scheme Document of the "Valuation Methodology" that the directors had employed to arrive at the debt to equity conversion price of one A1 Ordinary Share for each US$0.33 of Scheme Debt. That valuation methodology allegedly valued the Company as a going concern, but was described in the most general terms as being based upon a median of five unidentified "comparable businesses in the sector" to which a discount of "between 45-50%" had been applied to take account of various factors such as COVID-19 and the Group's "geographical location".

86. There is simply no way in which any reasonable Scheme Creditor could conceivably make an informed assessment of whether the debt to equity conversion rate was appropriate on the basis of such minimal information. The Scheme Document did not even state the resultant value attributed to the Company, still less give an indicative value of the A1 Ordinary Shares in the Company that would result from the debt to equity conversion.

87. Further, paragraph 6.6 of the Scheme Document stated that "The board has commissioned an independent [sic] to review its valuation methodology and key assumptions which supports its approach". This statement was obviously designed to provide some assurance to Scheme Creditors that the directors (all but one of whom had an interest in the outcome by reason of holding existing shares in the Company and/or Scheme Debt) had adopted an appropriate and fair approach, but no further details were provided of the nature or identity of the "independent" or the nature and precise outcome of their review.

88. In his subsequent evidence, Mr. Insley said that,

> "The Company commissioned a third-party firm to undertake an independent review of the Directors' valuation methodology of the Group. The terms of the engagement letter with that third party firm prevents the Company from being able to disclose the name or details of the valuation methodology used by that firm."

89. It is notable that even this evidence failed to identify the nature of the "third-party firm" that had been instructed, and in my judgment what it revealed of the approach of the directors is deeply unsatisfactory. The purpose of the directors causing the Company to instruct an independent party to review their valuation methodology could only have been for the purposes of proposing the Scheme to the Scheme Creditors. The review was also paid for using the money of the Company which would otherwise have been available to pay Scheme Creditors. In those circumstances, I cannot understand why the review was commissioned on terms that the identity of the third party should be withheld from Scheme Creditors. Moreover, and for similar reasons to my observations in Indah Kiat (see paragraph 65 above), if

the existence of such review was to be mentioned to Scheme Creditors in an attempt to bolster the credibility of the valuation methodology adopted by the directors, in my judgment it should at the very least have been made clear to the Scheme Creditors that the third party reviewer accepted no responsibility to them for the review, even to the extent of not allowing its identity to be disclosed to them.

90. Similar points can be made in relation to the pricing of the Rights Issue. The Scheme and Rights Issue are legally and commercially inter-conditional. There is no point in the Company promoting the Scheme unless it can raise money by way of the Rights Issue, and the Rights Issue (which is fully underwritten) will inevitably follow if the Scheme is sanctioned. The Scheme and the Rights Issue are in truth one composite proposal. In my judgment a reasonable Scheme Creditor being asked to vote on the Scheme therefore needed to be given the necessary information to understand the rationale and financial calculations which underlie both parts of the proposal.

91. Against that background, in my judgment it was not sufficient for the Scheme Document simply to have told Scheme Creditors that the Rights Issue would be at a price of $0.20 per new A1 Ordinary Share, that a full subscription for rights would entitle a member to acquire an equivalent number of A2 Ordinary Shares at par, that the Rights Issue would be fully underwritten, and that further details of the Rights Issue would be provided "in due course". Full details should have been provided as part of the Explanatory Statement. I also cannot see why the Scheme Document was so coy about making clear the identity of Aldridge Capital as the "cornerstone investor" which would be underwriting the Rights Issue.

92. Slightly more information was provided in paragraph 2.28 of the Addendum in answer to a question of why the Rights Issue was priced well below the conversion rate under the Scheme. The Addendum stated that,

> "In light of the above paragraph concerning valuation and the imperative to ensure the Rights Issue was fully underwritten and the funds available, it is common market practice to offer rights at a discount, there being examples of discounts being as large as 80%".

93. This appears to be an acceptance that in part the discount was offered by the directors to induce Aldridge Capital to agree to become the underwriter of the Rights Issue. There was, however, no identification or explanation of the comparability of the examples in which 80% discounts were apparently offered and which the directors appear to have taken into account in agreeing a discount of 40%. Nor was there any indication of whether there was any competitive process leading to the appointment of Aldridge Capital as underwriter or otherwise to explain how the directors arrived at a conclusion that this discount rather than any other percentage could have been offered to an underwriter.

94. The Addendum then went on to state that the directors "exercised their commercial judgment" in concluding that a discount of 40% was fair and reasonable to Scheme Creditors and that it was applied to encourage shareholders (including converted Scheme Creditors) to take up their rights. Beyond the bland statement that the directors exercised their "commercial judgment", these paragraphs provide no meaningful explanation of the process or methodology employed by the directors.

95. Nor was there any attempt to explain how the directors dealt with the obvious potential conflicts that they faced in these regards given their personal interests in Scheme Debt, as existing shareholders in the Company, and in the cases of Mr. Aldridge and Mr. Insley as a result of their interests in and representative role for Aldridge Capital. The only statement which might be thought to have been directed to that question was the one general and non-specific sentence in the Addendum that, "The application of discounts was considered and verified with the SchemeCo Group's [sic] third-party advisers". As with the valuation in relation to the debt to equity conversion, this was clearly designed to reassure Scheme Creditors and to induce them to vote in favour of the Scheme. However, there was no identification of the advisers, or of the terms upon which they had been engaged, or whether they had been prepared to accept any responsibility to Scheme Creditors in their consideration of whether the discount applied in the Rights Issue was indeed "fair and reasonable" to Scheme Creditors.

96. The consequence is that I do not consider that the Scheme Document contained sufficient information to enable a reasonable Scheme Creditor to assess whether the pricing or terms of the Rights Issue was fair to them or in their interests.

The consequences for Scheme Creditors of not taking up their rights

97. Because the Rights Issue is inextricably linked to the Scheme and would be fully underwritten, it is inevitable that a Scheme Creditor who decides that they do not wish to venture further money in subscribing for shares under the Rights Issue will see a dilution of the A1 Ordinary Shares issued to them in consideration for their Scheme Debt. In these circumstances it was vital for Scheme Creditors to be very clearly informed in the Scheme Document of the adverse consequences for them and the corresponding benefits which would be obtained by others if they did not take up their rights.

98. I have set out above the only paragraph of the Scheme Document which dealt with this matter. It appeared in the Chairman's letter and stated in relevant part,

> "Following the Rights Issue, if the Creditors took up their rights issue in full (in their capacity as converted shareholders only) they would hold in aggregate 74 per cent. of the issued share capital of SchemeCo. If the Creditors did not take up any of the Rights Issue they would hold (in their capacity as converted shareholders only) in aggregate 69 per cent. of the issued share capital of SchemeCo. It is acknowledged that some of the Creditors are also Shareholders of SchemeCo but for the purposes of this illustration this disregards their existing shareholding as at the date of this document."

99. Mr. Phillips submitted that this was misleading. He pointed out that this calculation appeared to assume that a total of about 56.2 million A1 Ordinary Shares would be issued to Scheme Creditors under the Proposed Scheme so that following the Scheme (but before the Rights Issue) a total of about 81.6 million shares in the Company will be in issue: (56.2/81.6) x 100 = about 69%.

100. However, since (for the reasons I have given above) it is inevitable that the Rights Issue will take place if the Scheme is sanctioned, and since the Rights Issue is fully underwritten, this means that if the Scheme is sanctioned, a further 15,000,000 A1 Ordinary Shares will inevitably be issued by the Company. That means that a total of about 96.6 million Ordinary Shares in the Company would be in issue. In that situation, if Scheme Creditors (in their capacity as such) did not take up any of the Rights Issue, they would in fact hold about 58% (and not 69%) of the issued share capital: (56.2/96.6) x 100 = about 58%.

101. In reality, as Mr. Phillips pointed out, the dilution of Scheme Creditors would actually be even greater. This is because anyone subscribing for their full allocation of A1 Ordinary Shares in the Rights Issue would be given the opportunity to purchase the same number of A2 Ordinary Shares as A1 Ordinary Shares for which they subscribed at only a further US$0.01 per share. In that situation, if Scheme Creditors (in their capacity as such) were not to take up any of the Rights Issue, they would in fact end up holding only about 50% of the issued share capital: (56.2/111.6) x 100 = about 50%.

102. Mr. Thornton QC did not dispute this analysis, and in my judgment there is no answer to it. As a result, I conclude that the Scheme Document was materially misleading in this important respect.

Provision of information to certain Scheme Creditors informally

103. At the hearing, Mr. Thornton QC sought to counter the deficiencies that I have outlined in the Scheme Document and Addendum by telling me, on instructions, that every Scheme Creditor had in fact been sent a personalised breakdown of their Scheme Debt, the shares to which they would be entitled under the Scheme and under the Rights Issue, and the cost of taking up those rights. He said that breakdown also showed what proportion of the overall capital of the Company the Scheme Creditor would be entitled to if they chose to participate in the Rights Issue and if they did not.

104. When the Company came to put evidence in to support this submission, however, it transpired that this was not the true position. What had in fact happened was that the Company had engaged in two rounds of informal communications outside the Scheme process with some, but not all, of the Scheme Creditors.

105. In the first, on or about 14 June 2020, Mr. Aldridge and two individuals at a firm called Short Partners, who were described as advisers, approached a selection of Scheme Creditors who he thought might be willing to agree to support the Scheme and to enter into a lock-up agreement. Mr. Aldridge's evidence was that ten Scheme Creditors were not approached, either because they had a small proportion of the Scheme Debt, or because they were creditors with whom the Company had been in dispute (i.e. most of the Opposing Creditors). A presentation was made to the selected creditors of the issues that the Company faced and the proposed restructuring. The evidence does not, however, reveal what the content of that presentation was.

106. Thereafter, Mr. Sykes and Mr. Aldridge sent the selected Scheme Creditors an email attaching an individual breakdown as regards the impact of the Scheme and the Rights Issue together with a draft lock-up agreement. That breakdown did not, however,

show what would happen in the event that the Scheme Creditor elected not to take up its rights.

107. The accompanying email stated (among other things),

> "As we have explained, we are under enormous time pressure. If you are prepared to support our scheme we would be grateful if you would sign and return the lockup agreement confirming you will vote in favour of the scheme straight away. I am sorry it is such a formal document <u>but we need it in this form to satisfy the courts</u>."
>
> (my emphasis)

108. It would seem that a significant number of Scheme Creditors were induced to enter into lock-up agreements by this approach. That can be deduced from the following paragraph in Part 5 of the Scheme Document issued on 3 July 2020,

> "3.1 SchemeCo has received Lock-up Agreements from each of the Directors (or entities in which they are affiliated) in respect of a total of US$9,619,620, representing approximately 52 per cent. of the aggregate Debt of SchemeCo as at close of business on 2 July 2020 (being the last business day prior to the publication of this document) confirming its or his or her approval to vote in favour of the Scheme at the Court Meeting.
>
> 3.2 In aggregate, therefore, [sic] SchemeCo has received Lock-up Agreements to vote in favour of the Scheme at the Court Meeting in respect of:
>
> 3.2.1 a total of 80 per cent. of the aggregate Debt of SchemeCo; and
>
> 3.2.2 a total of 58 per cent. by number of the lenders holding Debt."

109. The second round of communications came after the dispatch of the Explanatory Statement when, on 10 July 2020 the Company issued an investor up date to its existing shareholders which contained an "indicative table" which purported to show how each shareholder's existing shareholding might be affected by the Scheme and Rights Issue. For those shareholders who were also Scheme Creditors, the illustration showed how their Scheme Debt would be converted and how their individual shareholding would be affected if they were not to take up their rights. These breakdowns did not, however, deal with or correct the inaccuracy in the overall numbers given in the Scheme Document. They were also not sent to all Scheme Creditors, with the result that three Scheme Creditors (two of the Opposing Creditors and one other creditor with a small debt who was one of the two Scheme Creditors who did not vote at the Scheme Meeting) did not receive the communication.

110. Although Mr. Thornton QC sought to persuade me that any deficiencies in the Scheme Document had been remedied by these communications, I am not remotely

satisfied that this is so, or that I should in any event accept such a submission as a matter of principle.

111. As I have indicated above, the scheme process under Part 26 (and Part 26A) of the Act proceeds on the footing that creditors will be sent a formal explanatory statement which sets out a full explanation of the scheme and the interests of the directors and all the information that they reasonably require to make an informed decision as to how to vote on the scheme at the scheme meeting(s) ordered by the court.

112. It is obviously desirable for the scheme company to provide creditors with as much information as early as possible, and in as concise and comprehensible form as possible, to enable them to make their ultimate decision. However, as a matter of principle I do not believe that material deficiencies in the information provided in the formal scheme documents can ordinarily be remedied simply because the scheme company has in fact provided better information outside the formal scheme process. That is especially so if the additional information has only been given to some, but not all, scheme creditors.

113. That conclusion is reinforced where, as in the instant case, the provision of information outside the formal scheme process is connected with the use of lock-up agreements. Such agreements were not in use when the scheme process was originally formulated in the legislation, or when the basic approach of the court to questions such as the formulation of classes and the exercise of discretion were established in the authorities.

114. In recent times, however, it has become commonplace for companies that wish to put a scheme to their creditors to enter into, or offer to enter into, lock-up agreements with some, or even a large majority of scheme creditors prior to commencing the scheme process. One possible purpose of such a practice from the point of view of the company is, as David Richards J indicated in Telewest Communications plc (No.1) [2004] EWHC 924 at paragraph [52], to avoid a potential waste of time and costs of starting the scheme process if creditors who have indicated an intention to support a restructuring proposal are entirely free to sell their scheme debt or change their minds.

115. The widespread use of lock-up agreements in recent years is, however, not without difficulties. One such concern (not present in the instant case) relates to the payment of lock-up fees. In many schemes, the company might offer to pay a fee to induce scheme creditors to enter into a legally binding agreement at an early stage to support the proposed scheme. The payment of such fees has been accepted in a number of cases at first instance, but serious concerns remain: see e.g. the recent discussion by Falk J in Re Codere Finance 2 (UK) Ltd [2020] EWHC 2441 (Ch) at paragraph 51 et seq.. Questions may well arise as to whether the payment of such fees should either result in the court ordering separate class meetings for those who have locked-up (and may thus be unable to change their mind absent a material change of circumstances) and those who have not; or otherwise as to the reliability of a majority vote comprising creditors in receipt of a lock-up fee and those who have not qualified to receive it.

116. A second concern, which is relevant in this case, relates to the unequal provision of information to different groups of creditors.

117. In some (especially larger) cases, the first signatories to a lock-up agreement are usually the "ad hoc group" of creditors that has negotiated the terms of the restructuring with the company. Such creditors may (if they are willing to enter into a non-disclosure agreement) have been privy to unpublished financial information concerning the company during the negotiations, and may have decided to lock-up on the basis of that information. Once the scheme has been formulated, there may then be the publication of a simple "term-sheet", with or without an informal presentation, to other creditors, who are invited to enter into lock-up agreements on the basis of that (different) information.

118. Accordingly, by the time at which the formal scheme process is launched and the scheme document and explanatory statement is circulated, a large number of creditors may already have bound themselves to support the scheme on the basis of either more or less information than that which is contained in the scheme document and explanatory statement. Those who have bound themselves on the basis of less information may well regard themselves as unable to change their mind in light of what is included in the explanatory statement, especially if they have qualified for a fee by entering into the lock-up agreement at the earlier stage.

119. Moreover, when the matter comes back before the court for sanction, the majority vote in favour may well be made up of creditors who bound themselves to vote in favour at different times and on the basis of different information than was provided to other creditors in the formal explanatory statement. This inevitably calls into question the ability of the court to place the reliance which it ordinarily does upon the strength of the majority vote at the meeting as a reflection of the commercial interests of the class: see the observations of David Richards J in Re Telewest Communications (No.2) cited in paragraph 52 above.

120. The instant case is a clear example of the difficulties. A significant proportion of the Scheme Creditors voting in favour of the Scheme included the directors, or entities connected with them or represented by them, including Aldridge Capital. Such persons had access to unpublished up-to-date financial information concerning the Company and its subsidiaries, and advice from professionals and advisers which has not been disclosed to other Scheme Creditors in the Scheme Document or at all.

121. The majority also included some other Scheme Creditors to whom an informal approach and presentation was made by Mr. Aldridge and the two advisers from Short Partners before circulation of the Scheme Document. I have no idea what was said during such presentations, but it is clear that the Scheme Creditors were then provided with an indicative illustration which did not explain the effect of the Scheme Creditors not taking up their rights in the Rights Issue. The Scheme Creditors approached in this way were also not told that they could await the formal circulation of the Explanatory Statement and the court meeting. Instead they were sent an email which urged them to sign a lock-up agreement "straight away" and were given the wholly erroneous and misleading impression that this was in a form needed "to satisfy the court".

122. By the time that an illustration of the outcome which included the potential dilutive effect of the Rights Issue on individual holdings was provided to some of those Scheme Creditors – albeit in the form of an investor update to shareholders dated 10 July 2020 – it would seem that a significant proportion of the Scheme Creditors had

already signed a lock-up agreement committing them to vote in favour of the Scheme. It is unclear to me whether such creditors would then have regarded themselves as legally free to change their minds even had they wished to do so on the basis of the additional information. And as I have indicated, some Scheme Creditors were not supplied with any of the additional information at all.

123. In these circumstances, I do not consider that I can derive any comfort from the additional informal communications with some (but not all) Scheme Creditors, and I cannot see that it was sufficient to overcome the manifest defects in the contents of the formal Scheme Document and Addendum.

Should I nevertheless give effect to the majority vote?

124. Mr. Thornton QC finally submitted that I should not allow any deficiencies in the Scheme Document or Addendum to deprive the majority of Scheme Creditors of the opportunity to benefit from exchanging their worthless debt for shares. He submitted that I could be assured that the shares in the restructured Company would be worth at least US$0.20 each, because that is the amount of new money which Aldridge Capital is prepared to put into the Company for each share in the Rights Issue. He buttressed that submission with reference to three letters from Scheme Creditors (including in particular 21st Century) who supported the Company's efforts to continue as a going concern and said that they wished to see the Scheme approved as a means of ensuring its survival.

125. There are a number of difficulties with Mr. Thornton QC's submission, not least because it begs the question as to whether the Scheme Debt is in fact worthless, fails to address the issues concerning the appropriate allocation of value between the different groups of stakeholders in the Company, and requires me to make assumptions about the commercial motivations of Aldridge Capital in making a further investment in the Company at a price which has not been objectively justified to Scheme Creditors in any of the materials which I have seen.

126. I am also not persuaded by the broad argument – also expressed in the supporting letters - that I should sanction the Scheme to give the majority of Scheme Creditors the opportunity to exchange their debt for shares in the Company, and to give the Company the basis to undertake the Rights Issue in order to survive as a going concern. If the Company has the support of the majority of creditors and of Aldridge Capital, it is free to explore with them a consensual restructuring which could involve a conversion of their debt to equity and the injection of new money to strengthen the Company's balance sheet and provide working capital.

127. But the critical feature which the Company seeks to invoke by using Part 26 is its "formidable compulsion" to bind dissenting creditors. As the authorities to which I have referred make quite clear, the scheme jurisdiction under Part 26 cannot be used to force a compromise upon dissenting creditors unless there has been scrupulously fair and accurate compliance with the requirements of the statute and <u>Practice Statement</u>; and the court is not involved simply to rubber-stamp the wishes of the majority, irrespective of whether there has been such compliance.

128. In my judgment, the paucity of information provided by the Company as part of the scheme process in this case, and indeed its general approach to engagement with

creditors whom the directors clearly felt were irrelevant or would be an obstacle to their plans, fell a considerable distance short of what was required for a fair process under Part 26.

129. Whatever the Scheme Creditors who are connected with or represented by the directors, or those who were informally induced by the directors to enter into lock-up agreements, may have seen or been told, I cannot be satisfied that a reasonable creditor could take an informed decision as to whether the Scheme was in its interests on the basis of the very limited, and in one respect misleading, material in the Scheme Document and Addendum.

Conclusion

130. For these reasons, I decline to sanction the Scheme and I shall dismiss the Company's application.