

RE SOVA CAPITAL – COURT APPROVES AN UNSECURED CREDIT BID FOR THE FIRST TIME



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In *Re Sovo Capital Limited* (in special administration) [2023] EWHC 452 (Ch) the High Court approved the sale of a portfolio of securities held by a company in administration to an unsecured creditor in exchange for the waiver of the creditor's claim. In his judgment Miles J emphasised that the case raised "novel issues" which had not previously been decided by the courts (at [193]). Although he did not in his judgment use the term, this was the first time the Court has approved an unsecured "credit bid" for the assets of a company in administration.

Sova Capital Limited ("Sova") went into special administration under the Investment Bank Special Administration Regulations

2011 on 3 March 2022. Around 87% of its assets comprised Russian securities which, as a result of various sanctions regimes, would be difficult to realise.

Of the offers that were received, Sovo's special administrators (the "Special Administrators") considered an offer for the bulk of the Russian securities by one of Sovo's largest unsecured creditors ("Dominanta") to be the most advantageous. Notably, in consideration for those securities, Dominanta would waive its £233 million claim in Sovo's special administration (the "Transaction").

By their application to the court, the Special Administrators sought the Court's approval of the Transaction. Another of Sovo's unsecured creditors ("BZ"), who had also made a bid for the assets, opposed the Special Administrators' application for approval.

BZ's position was, in short, that the Transaction amounted to a distribution in specie to Dominanta and, as such, would be contrary to the pari passu principle. The pari passu principle is, of course, a fundamental principle of insolvency law and requires the equal distribution among unsecured creditors of available assets. On BZ's behalf it was submitted that, as a consequence of the Transaction, Dominanta would end up with Russian securities which could be worth more to it than the predicted dividends payable to Sovo's other unsecured creditors and therefore that the pari passu principle was infringed.



In order for the pari passu principle to be engaged, however, the Transaction would need to be a distribution. The pari passu principle does not apply in the context of a sale.

Crucially Miles J took the view that it did not amount to a distribution, but was properly characterised as a sale.

Characterisation of the Transaction required a focus on substance over form. Moreover, insofar as assessing substance is concerned, it is legal rather than economic substance that matters.

Looking at the terms of the Transaction, the Court concluded that it was a sale of certain assets in return for the waiver of Dominanta's claim in Sovo's administration. In this regard Miles J noted, in particular, the fact that the value put on Dominanta's offer for the purpose of the Transaction was not its full value, but rather the value of the dividend which it would have received in the event the Transaction did not go ahead.

In contrast, to characterise the Transaction as BZ had done – focusing on the possibility that Dominanta would end up with Russian securities which could be worth more to it than the predicted dividends payable to Sovo's other unsecured creditors – was to place too much emphasis on the economic outcome of the Transaction. It was the legal steps by which that economic outcome would be brought about that mattered for the purpose of characterisation. Looking at those steps, the Transaction was properly characterised as a sale, not a distribution and, as such, did not

contravene the pari passu principle.

The Transaction, characterised as a sale of assets in consideration for the waiver of Dominanta's claim in the special administration, the Transaction can therefore be seen as an unsecured "credit bid". Whilst the concept of a credit bid is familiar in the context of bids for assets by secured creditors (i.e. where a secured creditor bids the value of its secured debt in order to acquire the asset in respect of which it holds security), in the context of unsecured creditors this was unprecedented.

The opportunity for use of this novel mechanism arose in this case because of the difficulties faced by the Special Administrators in realising the Russian securities because of the impact of sanctions (which the court ultimately concluded the Transaction would not breach). The Transaction provided a way for the Special Administrators to unlock the value of the Russian securities.



The concept of an unsecured bid may, however, be utilised in other cases in the future (provided of course that it represents the best price for the assets reasonably obtainable). Should other opportunities for the use of the

unsecured credit bid mechanism arise, this case provides helpful guidance as to the appropriate methodology for valuing such a bid.

Crucially, the valuation is to be based on the dividend that the buyer would have received in the administration in the event that the proposed transaction does not take place. The value of the bid is not the full value of the buyer's claim.

[Mark Phillips KC, William Willson and Riz Mokal acted for the Special Administrators. Stephen Robins KC and Charlotte Cooke acted for BZ, the opposing creditor]

This article first appeared in the April 2023 edition of the South Square Digest.

