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Client Alert Commentary

Latham & Watkins Restructuring & Special Situations Practice 29 June 2021 | Number 2881

# High Court Declines to “Cram Down” Shareholders in Proposed Part 26A Restructuring Plan of Oil Company

***The decision provides new judicial guidance for determining the boundaries of cross-class cram down tests.***

On 28 June 2021, the High Court declined to sanction a restructuring plan proposed by Hurricane Energy plc (Hurricane), an AIM listed oil drilling company, under Part 26A of the Companies Act 2006 (Act). The plan would have seen shareholders diluted to 5% of Hurricane’s equity, with the remaining 95% issued to bondholders as consideration for a partial debt-for-equity swap.

This *Client Alert* examines Mr Justice Zacaroli’s reasoning and considers some of the lessons for future restructuring plans.

## Background

Hurricane’s shareholders had vigorously opposed the restructuring plan, with 92.34% voting against it in a class meeting that Mr Justice Zacaroli insisted Hurricane should convene. Shareholders also requisitioned an extraordinary general meeting under section 303 of the Act, to be held on 5 July 2021, with a view to replacing Hurricane’s entire board of directors.

Hurricane and an ad hoc committee of its bondholders invited the judge to exercise his power to sanction the plan against the wishes of shareholders using the cross-class cram down provision provided under section 901G of the Act, which gives the English court discretion to sanction a plan notwithstanding that one or more of the classes has not approved the plan by the requisite majority (i.e., 75% by value of those present and voting at the class meeting). In order to invoke this discretion, two conditions must be met (section 901G(2)-(5)):

- Condition A: “the court is satisfied that, if the compromise or arrangement were to be sanctioned under section 901F, none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative”.

- Condition B: “the compromise or arrangement has been agreed by a number representing 75% in value of a class of creditors or (as the case may be) members, present and voting either in person or by proxy at the meeting summoned under section 901C, who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative”.

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The "relevant alternative" is defined in section 901G(4) as being "whatever the court considers would be most likely to occur in relation to the company if [the plan] were not sanctioned".

The cross-class cram down power was a major innovation to English restructuring law when it was introduced via the Corporate Insolvency and Governance Act last year. Thus far, it has been used twice, in the cases of *Re Virgin Active Holdings Ltd*[1] and *Re Deep Ocean 1 UK Ltd*.[2] No such power exists in relation to the restructuring plan's legislative forebear, the scheme of arrangement.

In *Virgin Active*, Mr Justice Snowden identified three steps in relation to Condition A:

1. Identifying what would be most likely to occur in relation to the company if the plan were not sanctioned (i.e., the "relevant alternative")

2. Determining the outcome or consequences of that occurrence for the stakeholders subject to the cram down

3. Comparing that outcome with the outcome and consequences for those stakeholders if the plan were sanctioned

## The Decision

Mr Justice Zacaroli made the following observations regarding the three steps in relation to Condition A:

- On the first step, he concurred with the judicial comments in *Virgin Active* that the court is not required to be satisfied that a particular alternative would definitely occur, merely (where there are possible alternatives) which one is most likely to occur.

- On the second step, he agreed with the judicial comments in *Virgin Active* that the outcome or consequences for the shareholders is to be assessed primarily, <u>but not exclusively</u>, in terms of the anticipated returns on their claims. Further, with comments of Mr Justice Trower in *Deep Ocean* that "any worse off" is "a broad concept and appears to contemplate the need to take into account the impact of the restructuring plan on all incidents of the liability to the [stakeholder] concerned". Finally, in determining whether shareholders were "any worse off" as a result of the Hurricane plan, it was necessary to take into account all incidents of their rights as shareholders.

In addition, Mr Justice Zacaroli endorsed the comments in *Virgin Active* that the exercise at the second step is "inherently uncertain because it involves the Court in considering a hypothetical counterfactual which may be subject to contingencies and which will, inevitably, be based upon assumptions which are themselves uncertain".

The judge concluded that by reference to the three steps, the threshold for satisfaction of Condition A had not been met for the following reasons:

- The "relevant alternative" in Hurricane's case, in contrast to that in *Virgin Active*, was not immediate insolvency. Instead, the most likely occurrence if the plan did not succeed was, even on Hurricane's own submissions, the continuance of the business for at least a further year (to May 2022) before the bonds became due for payment. Whilst current projections showed that by May 2022 there would be a shortfall in Hurricane's resources to repay the bonds, there was no question of an immediate liquidation. Further, various possibilities suggested that Hurricane could continue beyond May 2022,

providing “a realistic prospect that it will retain an income producing asset of at least some value to its shareholders”.

- Having regard to the “inherent uncertainty” involved in the second step, the judge decided that he did not need to conclude that the most likely outcome from the relevant alternative was that there must be a return to shareholders at some point in the future. The fact that there was a realistic prospect that Hurricane would be able to discharge its obligations to the bondholders (based on a range of possibilities, including through refinancing any shortfall owing to the bonds), leaving assets with at least some potential for economic exploitation for shareholders, was enough to refute the idea that shareholders would be no better off under the relevant alternative than under the plan. Said Mr Justice Zacaroli:

> “In other words, to retain 100% of the equity in Company that is continuing to trade, with a realistic prospect of being able to repay the Bonds in due course, is to my mind a better position than immediately giving up 95% of the equity with a prospect of a less than meaningful return as to the remaining 5%”.

Because Condition A was not satisfied, the judge did not have to decide the question of whether he would have sanctioned the plan. Regardless, the judge noted, he would have declined to do so.

According to Mr Justice Zacaroli, the question of whether the shareholders were out of the money was a critical element in determining both whether they would be any worse off in the plan than in the relevant alternative and also to the exercise of discretion to “cram down”. However, the test that Hurricane and the ad hoc committee had set for determining whether shareholders were out of the money was too narrow, focussed as it was only on whether Hurricane could generate sufficient cash from trading alone to repay the bonds in full. Too many variables could affect this outcome (not least the actual rather than the projected future oil price), and too many other options and possibilities were open to Hurricane, given that liquidation was not imminent, for the enquiry to be limited in the way that Hurricane and the ad hoc committee proposed.

As such, the judge did not accept the urgency to restructure the bonds that Hurricane and the ad hoc committee claimed, and said it was “reasonable to believe that a restructuring could be undertaken at a later stage”, which reinforced “the conclusion that shareholders should not immediately be deprived of anything other than a de minimis interest in the equity”. In particular, the judge was not persuaded that the need to renew a critical drilling rig charter would be as adversely affected by the failure of the proposed plan as Hurricane claimed, noting that “much more compelling evidence” was required from the company to back this assertion up than had been offered.

## Conclusion

The judgment is a welcome addition to the growing body of restructuring plan case law in England. The parameters of the cross-class cram down tests have been much debated amongst academics and practitioners, and more judicial guidance is helpful in delineating the boundaries more precisely. It is important that restructuring plans be successful and have some degree of predictability so that companies are not dissuaded from using them. At the same time, using restructuring plans to bind classes against their will is a potentially draconian power. Mr Justice Zacaroli has demonstrated that the court will consider carefully the exercise of that power, particularly if the alternative is not obviously immediate insolvency. In this respect the judgment echoes the recent scheme of arrangement decision in *ALL Scheme Limited*[3], in which Mr Justice Miles rejected at sanction a compromise of consumer redress claims against Amigo Loans, in large part due to him being unconvinced about Amigo’s claims about its

imminent insolvency. Claims as to what the alternatives really are will be subject to close scrutiny, particularly when the court is being invited to use its restructuring plan cross-class cram down power, and robust evidence will be needed from companies to back up those claims.

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**Endnotes**

[1] [2021] EWHC 1246 (Ch).

[2] [2021] EWHC 38 (Ch).

[3] [2021] EWHC 1401 (Ch).